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TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1935

No. 61

JOHN A. NELSON COMPANY, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

PETITION FOR CERTIORARI FILED MAY 20, 1935.

CERTIORARI GRANTED OCTOBER 14, 1935.

SUPREME COURT OF THE UNITED STATES

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COMMISSIONER OF INTERNAL REVENUE.

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1 John A. Nelson Company, *Petitioner,*
vs.
Commissioner of Internal Revenue, *Respondent.*
} Docket No. 44700.

Appearances:

For Petitioner: B. W. Flinn, Esq., (Withdrawn) Frank E. Seidman, C. P. A.

For Respondent: B. Fullerton, Esq., John D. Kiley, Esq., J. E. Marshall, Esq., C. A. Ray, Esq., Claude Kitchin, Esq.

DOCKET ENTRIES.

Transferred to Mr. Smith 4/8/33.

1929

May 23—Petition received and filed. Taxpayer notified. (Fee paid)

May 24—Copy of petition served on General Counsel.

July 23—Answer filed by General Counsel.

July 24—Copy served on taxpayer—assigned General Calendar.

Dec. 20—Motion to transfer to the Grand Rapids, Michigan, Circuit Calendar, filed by taxpayer. 1/11/3[illegible]anted.

Dec. 26—Notice of withdrawal of B. W. [illegible]n and substitution of Frank E. Seidman as counsel for taxpayer filed. See 41984.

1930

Jan. 11—Notice of appearance of Frank E. Seidman as counsel for taxpayer filed.

May 7—Hearing set June 25, 1930 at Grand Rapids, Michigan.

June 26—Hearing held before W. D. Love, Division 12. Submitted on stipulation of facts. Stipulation of facts filed. Briefs due Nov. 15, 1930.

July 30—Transcript of hearing of June 26, 1930 filed.

Nov. 14—Motion for extension to 2/1/31 to file brief filed by General Counsel. See 32986. 11/18/30 granted.

Nov. 15—Motion for leave to file amendment to petition to conform pleadings to proof filed by taxpayer.

Nov. 15—Brief filed by taxpayer. See 32986.

1931

Jan. 29—Motion for extension of time to Feb. 10, 1931 to file brief filed by General Counsel. Granted.

Feb. 10—Motion for extension to 4/11/31 to file brief filed by General Counsel. 2/10/31 granted.

Mar. 4—Motion of Nov. 15, 1931 granted.

Mar. 11—Answer to amendment to petition filed by General Counsel. Copy served 3/14/31.

Mar. 27—Brief filed by General Counsel.

Apr. 30—Reply brief filed by taxpayer.

Nov. 30—Findings of fact and opinion rendered—Wm. D. Love, Division 12. Judgment will be entered under Rule 50.

Dec. 19—Order that division report promulgated Nov. 30, 1931 be reviewed by the Board entered.

1932

Apr. 13—Order that prior submission be set aside and case reopened for further hearing in Washington, D. C., 5/25/32, at which time parties may offer further evidence entered.

May 7—Motion to offer further, roal and documentary evidence with respect to certain issues filed by General Counsel. 5/13/32 denied.

May 21—Motion for a continuance to July 11, 1932 filed by taxpayer. 5/24/32 granted—hearing continued to July 27, 1932.

June 20—Motion for continuance to 8/10/32 filed by General Counsel. 6/22/32 granted.

Aug. 8—Order striking from calendar of Aug. 10, 1932 and set for Sept. 14, 1932 entered.

Aug. 10—Motion to vacate order of 4/13/32 filed by taxpayer.

Aug. 19—Order that motion filed 8/10/32 be set for hearing Sept. 14, 1932 at Washington, D. C., entered.

Sept. 14—Hearing had before Mr. Love on petitioner's motion to vacate order of April 13, 1932. Petitioner's brief due in 60 days.

Oct. 4—Transcript of hearing 9/14/32 filed.

Nov. 14—Motion for 15 days extension to file brief filed by taxpayer. 11/15/32 granted.

Nov. 28—Brief filed by taxpayer.

1933

May 31—Order that petitioner's motion to vacate order of 4/13/32 be denied entered.

May 31—Memorandum sur order entered.

June 23—Findings of fact and opinion rendered—Charles P. Smith, Division 5. Judgment will be entered under Rule 50.

Aug. 16—Notice of settlement filed by General Counsel.

Aug. 19—Hearing set Sept. 6, 1933 on settlement.

Sept. 6—Hearing had before Mr. Trammell on settlement—not contested—referred to Mr. Smith for decision.

Sept. 6—Consent to settlement filed by taxpayer.

Sept. 7—Decision entered—Charles P. Smith, Division 5.

Nov. 28—Petition for review by U. S. Circuit Court of Appeals, 7th Circuit, with assignments of error filed by taxpayer.

Nov. 28—Proof of service of petition and praecipe filed by taxpayer.

Nov. 28—Praecipe filed.

Dec. 21—Statement of evidence lodged by taxpayer.

Dec. 21—Notice of lodgment of statement of evidence and hearing on Jan. 10, 1934 to approve said statement filed by taxpayer.

1934

Jan. 10—Hearing had before Mr. Goodrich on approval of statement of evidence—respondent accepts petitioner's statement—referred to Mr. Smith for approval.

Jan. 10—Statement of evidence approved and ordered filed.

Jan. 23—Order entered extending the time for transmission and delivery of the record to Jan. 31, 1934.

3 UNITED STATES BOARD OF TAX APPEALS. Filed M 1929.

John A. Nelson Company, Harrison Avenue & Eleventh Sts., Rockford, Illinois
vs.
Commissioner of Internal Revenue, Washington, D. C.
} Docket No. 44700.

PETITION.

Filed May 23, 1929.

The above named petitioned hereby petitions for a re-examination of the deficiency set forth by the Commissioner of

Internal Revenue in his notice of deficiency (Symbols IT: AR: D-60 D WFD) dated March 25, 1929 and as a basis of their proceedings alleges as follows:

1. The petitioner is an Illinois corporation with principal office at Rockford, Illinois and is non-operative at the present time, but was formerly engaged in the manufacture and sale of milling and adding machines.

2. The notice of deficiency, a copy of which is attached and is marked Exhibit "A," was mailed to the petitioner on March 25, 1929.

3. The taxes in controversy are the corporation income taxes for the calendar year 1926.

4. The determination of taxes set forth in said notice of deficiency is based upon the following errors:

(a) The Commissioner of Internal Revenue in computing the tax liability for the calendar year 1926 has erroneously increased income by capitalizing a bonus paid to designers in the amount of $16,686.57.

(b) The Commissioner of Internal Revenue in computing the tax liability for the calendar year 1926 has erroneously increased income in the amount of $322,980.29, which amount represents the reserve for unrealized profit on installment sales.

5. The facts upon which the petitioner relies as a basis for their proceedings are as follows:

(a) During the year 1923 the corporation entered into a contract with Sundstrand Brothers wherein they agreed to pay the Sundstrand Brothers a yearly bonus based on the net profits of the business. This bonus was, according to the contract, payable in consideration of the services to be rendered and services having been rendered in the past and as additional compensation for patents already transfrred to the corporation. Pursuant to the contract, bonuses were paid to the Sundstrand Brothers during the year 1926 and the Commissioner of Internal Revenue has disallowed the bonus paid as compensation and has capitalized the payments made as cost of patents.

(b) For the years prior to 1926 the corporation has reported income of the installment sales on the installment basis. The reserve for unrealized profit on installment sales at December 31, 1926 was $322,980.29. At December 31, 1926 the petitioner transferred all of its assets excepting a certain amount of cash to the Sundstrand Corporation of Delaware in exchange for cash and preferred stock, thus constituting a reorganization.

6. The petitioner prays for relief from the deficiency asserted by the respondent on the following and each of the following particulars:

(a) That in arriving at the tax liability of the John A. Nelson Company for the calendar year 1926 the taxable income as set forth in the Commissioner's letter dated March 25, 1929 should be reduced $16,686.57 representing the bonus paid to the Sundstrand Brothers.

(b) That in arriving at the tax liability of the John A. Nelson Company for the calendar year 1926 the taxable income as set forth in the Commissioner's letter dated March 25, 1929 should be reduced $322,980.29 which amount represents the reserve for unrealized profit on installment sales at December 31, 1926.

Whereof, the petitioner prays that this Board may hear and re-determine the deficiency herein alleged.

(Signed) B. W. FLINN,
Accountant for Taxpayer
501 Manufacturers Nat'l Bank Bldg.
Rockford, Illinois

HUGO L. OLSON, being duly sworn, says that he is the Secretary of the John A. Nelson Company, the taxpayer named in the foregoing petition and as such secretary is duly authorized to verify the foregoing petition; that he has read the said petition or has had the same read to him and is familiar with the facts therein contained and that the facts therein stated are true, except such facts as are stated upon information and belief and these facts he believes to be true.

(Signed) HUGO L. OLSON.

Subscribed and Sworn to before me this 21st day of May, 1929.

(c) ELSIE BROITZMAN,
Notary Public.

6 TREASURY DEPARTMENT

Washington

Office of
Commissioner of Internal Revenue

Address Reply to
Commissioner of Internal Revenue
and Refer to

Mar. 25, 1929

John A. Nelson Company,
Harrison Ave. and 11th Street,
Rockford, Illinois.

Sirs:

In accordance with the provisions of Section 279(a) of the Revenue Act of 1926, there has been assessed against you an income and profits tax amounting to $45,855.03 for the taxable year 1926, the details of which are set forth in the statement attached.

In accordance with the provisions of Section 274(a) of the same act, you are allowed sixty days (not counting Sunday as the sixtieth day) from the date of the mailing of this letter within which to file a petition with the United States Board of Tax Appeals, contesting in whole or in part the correctness of this determination.

However, If You Do Not Desire To Petition, you are requested to execute the enclosed Form 866 and forward both original and duplicate to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7.

Respectfully,

D. H. BLAIR,
Commissioner.

By (Signed) C. B. ALLEN,
Deputy Commissioner.

Enclosures:
Form 866
Form 882
Statement

7 IT:AR:R-60D WFD

Statement of Returns Examined
and
Resulting Tax Liability

Mar. 25, 1929

Returns Examined.

	Year	Form
Parent		
John A. Nelson Company, Rockford, Illinois.	1926	1120 (Cons.)
Subsidiary Companies:		
Sundstrand Adding Machine Company, Rockford, Illinois.	1926	"
Sundstrand Adding Machine Company, New York, N. Y.	1926	"

Tax Liability.

John A. Nelson Company

Year	Correct Tax Liability	Tax Previously Assessed	Deficiency
1926	$99,426.91	$53,571.88	$45,855.03

Sundstrand Adding Machine Company,
Rockford, Ill.
None

Sundstrand Adding Machine Company,
New York, N. Y.
None

The adjustments producing the above deficiency are shown in the attached Schedules 1 to 3, and Exhibit A.

8 Schedule 1.

Net Income.

Net income as disclosed by return	$396,588.76
As corrected	736,255.62
Net adjustment	$399,666.86
Unallowable deductions and additional income:	
(a) Patent bonus	$ 16,686.57
(b) Profit on installment sales	322,980.29
Total	$339,666.86

Schedule 1-A.

Explanation of Items Changed.

(a) Patent bonus paid in 1926 and charged to expense, now capitalized	$ 23,030.83
Amortization allowed	6,344.26
Amount disallowed	$ 16,686.57

For detailed computation see Exhibit A, attached.

(b) Taxpayer has been allowed to report income on the installment sales basis for the years 1918 and 1926, inclusive. The reserve for unrealized profit in installment sales at December 31, 1926, was $322,980.29. See return, Schedule 22-F for computation. As of December 31, 1926, the taxpayer corporation transferred all its assets and liabilities, except certain cash and accounts payable as set forth in return, Schedule M, under a plan of sale merger to the Sundstrand Corporation of Delaware for $2,100,000.00 cash and 14,030 shares of preferred stock realizing 100% for its total outstanding installment accounts receivable. See return, Schedule M for balance sheet date of sale.

9 Schedule 2.

Consolidated Net Income—1926.

Net income as corrected:

John A. Nelson Company, Schedule 1	$736,255.62	
Standard Adding Machine Company of New York, as shown on return	240.01	
Total		$736,495.63

Schedule 3.

Computation of Tax.

Income Tax.

Net income for taxable year, Schedule 2	$736,495.63
Income tax 13½ per cent	99,426.91
Total previously assessed	53,571.88
Additional tax to be assessed	$ 45,855.03

10

EXHIBIT A.

Computation of Amortization of Patent Bonus Capitalization.

Date Acquired	Remaining Life from December 31, 1926	Amount Capitalized Year 1926	Amount Amortized
1911	1½	$853.00	$568.67
1916	6½	853.00	131.23
1916	6½	853.00	131.23
1920	10½	853.00	81.24
1921	11½	853.00	74.17
1922	12½	853.00	68.24
1922	12½	853.00	68.24
1923	13½	853.00	63.18
1923	13½	853.00	63.18
1924	14½	853.00	58.83
1924	14½	853.00	58.83
1924	14½	853.00	58.83
1924	14½	853.00	58.83
1924	14½	853.00	58.83
1924	14½	853.00	58.83
1924	14½	853.00	58.83
1924	14½	853.00	58.83
1924	14½	853.00	58.83
1924	14½	853.00	58.83
1925	15½	853.00	55.03
1925	15½	853.00	55.03
1926	16½	852.98	51.69
1926	16½	852.97	51.69
1926	16½	852.97	51.69
1926	16½	852.97	51.69
1926	16½	852.97	51.69
1926	16½	852.97	51.69
Totals		$23,030.83	$2,257.88

Summary.

	Amount Capitalized	Amortization Allowed	Unamortized Balance
1923 per prior Revenue Agent's report	$11,516.56	$ 1,056.99	$10,459.57
1924 per prior Revenue Agent's report	15,827.68	2,346.62	13,481.06
1925 per prior Revenue Agent's report	19,371.18	4,086.38	15,284.80
12/31/1925 per prior Revenue Agent's report	$46,715.42	$ 7,489.99	$39,225.43
1926	23,030.83	6,344.26	16,686.57
12/31/1925 Totals	$69,746.25	$13,834.25	$55,912.00

ıly 23. 11 * * (Caption—44700) * *

ANSWER.

Filed Jul 23 1929.

The Commissioner of Internal Revenue by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, for answer to the petition of the above-named taxpayer, admits and denies as follows:

1. Admits the allegations contained in paragraph 1 of the petition.

2. Admits the allegation contained in paragraph 2 of the petition.

3. Admits the allegations contained in paragraph 3 of the petition.

4. Denies that the Commissioner erred as alleged in subdivisions 4(a) and 4(b) of paragraph 3 of the petition.

5. Denies generally and specifically each and every allegation set forth in taxpayer's petition not hereinbefore admitted, qualified or denied.

Wherefore, it is prayed that the taxpayer's apppeal be denied.

(Signed) C. M. Charest,
C. M. Charest,
General Counsel,
Bureau of Internal Revenue.

Of Counsel;
Philip M. Clark,
Special Attorney,
Bureau of Internal Revenue.

PMC MT

12 • • (Caption—44700) • • Filed Mar 1932.

AMENDMENT TO PETITION.

Filed—Mar. 4, 1932.

Now comes the petitioner, by its counsel, Frank E. Seidman, and moves that the petition in this cause be amended in the following respects:

1. That there be added to paragraph 4, sub-division (c) as follows:

(c) The inclusion in income for the year 1926 the amount of $6,864.68 resulting from collections in 1926 on installment sales made prior to 1924.

2. That Paragraph 5 be amended to add sub-division (c), as follows:

(c) The petitioner, in its original 1924 return, filed prior to February 26, 1926, changed its method of reporting income to the installment basis. Its return for 1926 was prepared on the installment basis. In arriving at the deficiency, the Commissioner included in taxable income for 1926 the amount of $6,864.68, representing profit computed by him on collections in 1926 from installment sales made prior to 1924.

3. That Paragraph 6 be amended so as to add sub-division (c) as follows:

(c) That taxable income for the year 1926 should be reduced by $6,864.68.

(s) FRANK E. SEIDMAN,
Counsel for Petitioner,
Grand Rapids Savings Bank Bldg.,
Grand Rapids, Michigan.

13 • • (Caption—44700) • • Filed Mar 1931.

ANSWER TO "AMENDMENT TO PETITION."

Filed Mar. 11, 1931.

Comes now the Commissioner of Internal Revenue by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, and answering the "Amendment to Petition" filed in accordance with the motion granted March 4, 1931, admits and denies as follows:

1. Denies paragraph 4(d) and 5(c) added to the original petition by paragraphs 1 and 2 of the amendment to petition filed in accordance with the motion granted March 4, 1931.

Denies each and every allegation of fact contained in said amendment to petition not hereinbefore specifically admitted, qualified or denied.

Wherefore, it is prayed that the determination of the Commissioner be affirmed.

(Signed) C. M. CHAREST
General Counsel, Bureau of Internal Revenue.

Of Counsel:
BROOKS FULLERTON,
Special Attorney,
Bureau of Internal Revenue.

3/10/31

ent of lence filed 10, 1934.

62 • • (Caption—44700) • •

Lodged Dec. 21, 1933.

Filed Jan. 10, 1934.

The following is the STATEMENT OF EVIDENCE, in narrative form, in the above entitled cause:

The above entitled cause came on for hearing before Honorable William D. Love, member of the United States Board of Tax Appeals, on June 26, 1930, at Grand Rapids, Michigan, J. S. Seidman, Esq. and F. E. Seidman, C. P. A., appearing for John A. Nelson Company, Petitioner, and John D. Kiley, Esq. (C. M. Charest, Esq., General Counsel, Bureau of Internal Revenue) appearing for the Commissioner of Internal Revenue, Respondent.

The petitioner and the respondent entered into a written stipulation which was received by the Board member and the case was submitted on the stipulation of facts. The stipulation as later corrected by motion dated November 14, 1930 of petitioner and consented to by the respondent, reads insofar as is here material, as follows:

"1. The petitioner is an Illinois corporation, with its principal office at Rockford, Illinois. It is now inactive, but during the years 1924 to 1926, inclusive, it was engaged
63 in the manufacture and sale of milling and adding machines under the name of Rockford Milling Machine

Company. In June, 1926, the name of the corporation was changed from Rockford Milling Machine Company to Sunstrand Corporation. In December, 1926, its name was changed to John A. Nelson Company.

"12. On December 31, 1926, petitioner was a party to a reorganization, pursuant to the plan of which it transferred substantially all of its properties to the Sunstrand Corporation of Delaware in exchange for 14,060 shares of the preferred stock of the Delaware Corporation, and $2,000,000 cash. The petitioner immediately used part of the cash so received to retire its own preferred stock and immediately distributed the preferred stock and the balance of the cash so received to its own stockholders, pursuant to the reorganization plan. Exhibits 2 and 3 respectively set forth the contract between petitioner and Elliott-Fisher Company, and the minutes of the meeting of petitioner's stockholders in respect of these transactions.

"13. No gain or loss was recognized or reported by the petitioner in its 1926 return with respect to the transactions set forth in Paragraph 12. This treatment was approved by the respondent, except as set forth in Paragraph 14.

"14. As of December 31, 1926, the books of the petitioner showed a reserve for 'Unrealized Profit' on installment sales in the amount of $322,980.29. The respondent added to petitioner's income, in arriving at the deficiency here in question, the $322,980.29, on the ground that the petitioner col-
64 lected, when it exchanged its assets for stock and cash, 100% for the total outstanding installment accounts receivable.

(Signed) FRANK E. SEIDMAN
Frank E. Seidman,
Attorney for Petitioner.

(Signed) C. M. CHAREST
C. M. Charest,
General Counsel, Attorney for Respondent."

65 "EXHIBIT 2.

"Agreement made this 18th day of November, 1926, between Sundstrand Corporation, a corporation of the State of Illinois (hereinafter called 'Sunstrand Corporation') and Elliott-Fisher Company, a corporation of the State of Delaware (hereinafter called 'the Company'), Witnesseth:

"That in consideration of the sum of One Dollar ($1.00) by each party paid to the other and in further consideration of the mutual agreements of the parties herein contained, it is agreed by and between the parties hereto as follows:

"Sundstrand Corporation represents that it owns the entire Adding Machine Business formerly operated under the corporate name of the Rockford Milling Machine Company, and that it will presently acquire all of the approximately 8½ acres of land and all of the buildings thereon immediately adjacent to its plant, formerly owned by Rockford Tool Company of Rockford (now owned by Sundstrand Machine Tool Company) and that it furthermore owns among other things certain real estate, plant, buildings, cash, accounts and notes receivable, merchandise, tools, equipment, patents, patent rights, licenses, stock in subsidiary companies and other property, tangible and intangible, (all thereof including the said land and buildings to be acquired from Sundstrand Machine Tool Company being sometimes hereinafter referred to as the 'Sundstrand Corporation's property') as will be
66 more fully disclosed by its books and records which are to be subject to examination by the Company as hereinafter provided.

"The Company shall cause a new corporation to be organized having a presently issued capital stock consisting of

"'(a) 12,500 shares of $7.00 preferred stock of the par value of $100. each; each share of such $7.00 preferred stock shall be entitled in preference to the common stock to dividends at the rate of $7.00 per share per annum, payable quarterly upon such dates as shall be from time to time determined by the Board of Directors, and such dividends shall be cumulative from the date of issue of such $7.00 preferred stock. In any distribution of assets other than by dividends from surplus or profits, the $7.00 preferred stock shall also have a preference over the common stock until there shall have been paid on such $7.00 preferred stock $100.00 per share plus all accumulated unpaid dividends thereon and the call premium thereon, if any, applicable with respect thereto in the year of such distribution. The $7.00 preferred stock shall be callable in whole or in part upon any dividend date, upon thirty days previous notice at the option of the corporation at $100.00 per share, plus all accumulated unpaid dividends thereon, if such call is made before the calendar year 1932. After the calendar year 1931 the $7.00 preferred stock shall be callable in whole or in part, upon any dividend date, upon thirty days previous notice at the option of the corpora-

tion on the following basis, plus all accumulated unpaid dividends thereon:

During the calendar year 1932 at $102.00 per share,
During the calendar year 1933 at $104.00 per share,
During the calendar year 1934 at $106.00 per share,
During the calendar year 1935 at $108.00 per share,
During the calendar year 1936 and thereafter at $110.00 per share.

The same basis for the retirement of the preferred stock shall apply in the event of the liquidation of the corporation as is applicable in the case of the optional retirement. The $7.00 preferred stock shall have no voting power unless
67 dividends thereon at the rate herein provided shall be in default in the amount of at least $7.00 per share. In the event of such default, each share of the $7.00 preferred stock shall entitle the holder thereof to one vote until such default shall have been cured. In addition to these provisions, the $7.00 preferred stock shall make provision for the following:

"1. No dividends on the common stock of the corporation shall be declared or paid, unless the corporation has an earned surplus of an amount equalling at least twice the annual dividend requirements on the $7.00 preferred stock, based upon the amount of $7.00 preferred stock outstanding at the date when the common stock dividend is declared.

"2. Except as herein otherwise expressly provided, no change shall be made in the share capitalization of the new corporation which shall increase the number of shares of $7.00 preferred stock outstanding or decrease the amounts which the holders of outstanding $7.00 preferred stock are entitled to receive as dividends or in distribution of assets in preference to shares of the common stock or decrease the price at which the $7.00 preferred stock may be redeemed or otherwise retired unless the holders of two-thirds of the $7.00 preferred stock then outstanding shall consent thereto, in writing or vote therefor at a meeting of stockholders called and held for such purpose.

"3. No mortgage (except purchase money mortgages) creating a lien upon any of the fixed assets of the new corporation nor any issue of prior preference preferred stock shall be made by the new corporation if holders of two-thirds of the $7.00 preferred stock then outstanding shall dissent therefrom by vote by ballot at a meeting called for the purpose. Notice of such meeting, stating the intention of the new corporation to make any such mortgage or any such issue of prior preference preferred stock shall be given to the hold-

ers of the $7.00 preferred stock then outstanding in the manner provided in the by-laws of the new corporation for notice of any special meeting of stockholders.

"(b) 30,000 shares of common stock without nominal
68 or par value; dividends may be paid upon the common stock only when dividends have been paid or funds have been set apart for the payment of dividends as aforesaid on the $7.00 preferred stock for the then current dividend period and after the surplus above mentioned, has been provided; but whenever such surplus shall have been provided and dividends on the $7.00 preferred stock have been paid or funds shall have been set apart for the payment thereof, all as aforesaid, then dividends upon the common stock may be declared payable then or thereafter out of any surplus or net profits then remaining. The $7.00 preferred stock shall not receive any dividends or shares in distribution in excess of the amounts above provided, but the common stock alone shall receive all further dividends and shares in distribution. Each holder of common stock shall be entitled to one vote for each share of such stock held by him.

"It is agreed notwithstanding the foregoing that the new corporation may issue such additional shares of $7.00 preferred stock as may be necessary or desirable in connection with the settlement hereunder of the Profit and Loss of the Sundstrand Corporation between September 30, 1926 and the closing date of the purchase herein contemplated and for the adjustment of the contract between the Sundstrand Corporation and Messrs. Gustaf David and Oscar J. Sundstrand, and for the settlement of a License Agreement under the Gubelman patents and in addition thereto not to exceed 1000 shares for the settlement or adjustment of any other liabilities or contracts of the Sundstrand Corporation assumed by the new corporation. The new corporation may also issue from time to time such additional shares of common stock as may be deemed necessary or desirable for any purpose.

"The new corporation shall be incorporated under the Laws of such state and shall have such powers and charter
69 provisions and such by-laws as counsel for the company may deem necessary or advisable, not inconsistent, however, with the provisions contained herein with respect to the common and preferred stock of the new corporation.

"Sundstrand Corporation will convey and transfer all of the Sundstrand Corporation's property including, without limitation by reason of the enumeration thereof, all of the property and assets of the Sundstrand Adding Machine Com-

pany of Illinois, the Sundstrand Canadian Adding Machine Company, Limited of Toronto, Canada, the Sundstrand Adding Machine Sales Company, Inc., and of all other subsidiary companies, if any, and the land and buildings to be acquired as hereinabove provided from Sundstrand Machine Tool Company to the new corporation or its nominee or nominees, free of any lien, incumbrance, indebtedness or charge thereon or with respect thereto, which could or might affect the title thereto; except, however it shall not convey and transfer the sum of $100,000.00 in cash which is to be retained by the Sundstrand Corporation. It is understood and agreed that the new corporation shall assume all ordinary liabilities of the character and substantially the approximate amount set forth in the attached tentative balance sheet marked Exhibit A and also all outstanding contracts of the Sundstrand Corporation and its subsidiary companies hereinbefore expressly mentioned if the transfer herein contemplated shall be made; but the new corporation shall not, unless it elects so to do, assume or be obligated in any way by or with respect to any liabilities or contracts of the Sundstrand Corporation or its said subsidiaries unless such liabilities or contracts shall have been disclosed to the Company prior to the giving by the Company of the notice required herein to fix the date for the transfer of the property and assets of the Sundstrand Corporation.

"Simultaneously with said transfer, the Company will cause the new corporation to issue to or in accordance with the direction of Sundstrand Corporation, 12,500 shares of the $7.00 preferred stock of the new corporation and to pay to said Sundstrand Corporation, $2,000,000.00 in cash; provided that the Company will also cause the new corporation, as soon as the facts with respect thereto can be ascertained and determined, to issue to or in accordance with the direction of the Sundstrand Corporation, such additional shares of the $7.00 preferred stock of the new corporation as shall equal at $100.00 per share, the amount of net profit, if any, of the Sundstrand Corporation, arising from its business from and after September 30, 1926, to the date of said transfer and provided also that if a loss shall result from the operation of the Sundstrand Corporation's business in the period from and after September 30, 1926 to the date of said transfer, said 12,500 shares of the $7.00 preferred stock of the new corporation shall be reduced on the basis of one share for each $100.00 of such loss. The net profit of the Sundstrand

Corporation for the period from September 30th, 1926 to the date of said transfer as herein provided, shall be calculated in accordance with good accounting practice.

"Simultaneously with, or at the Company's option before, said transfer of the Sundstrand Corporation's property
71 to the new corporation, the Company will cause the new corporation to issue to the Company, 90,000 shares of its common stock upon payment therefor by the Company of the sum of $2,000,000.00 in cash.

"Sundstrand Corporation has submitted to the Company, a financial statement of its assets and liabilities as of September 30, 1926. Said financial statement indicates tangible assets in excess of $2,420,000; Liabilities of approximately $331,000. and Tangible Net Worth in excess of $2,090,000.00. It is represented that the estimated net profit for the year 1926, after all taxes, bonuses and other charges, will be approximately $400,000.00. It is also represented that the assets appearing in the statement of assets and liabilities are valued on the following basis:

"(a) Accounts receivable per balances as shown by the individual detail ledger accounts.

"(b) Inventory at cost or market, whichever is lower.

"(c) Subsidiary companies at book value. (Parent Company Books).

"(d) Fixed Assets per recent appraisal of Coats and Burchard, plus additions at cost, less depreciation.

"(e) Deferred charges—estimated values.

"(f) Patents and good-will, as specifically agreed upon.

"Sundstrand Corporation represents that at the time of such transfer of the Sundstrand Corporation's property to the new corporation, the net worth of Sundstrand Corporation will be such that the financial status of the new cor-
72 poration will then be as good or better than that shown by the tentative balance sheet hereto annexed and marked Exhibit A, less $100,000. in cash, plus any operating profits made by the Sundstrand Corporation, between September 30, 1926 and the date of such transfer.

"The Company shall be afforded a full opportunity to make at its own cost and expense, an exhaustive audit and investigation by such representatives as it may select of the financial status, assets, business and prospects of the Sundstrand Corporation and for that purpose to examine and investigate all of its books, papers, records, products and property and all other matters and details of its business and to con-

tinue such audit and investigation down to the actual time of transfer of the Sundstrand Corporation's property, and if not satisfied from such audit and investigation (a) that the financial status of the new corporation will be as above provided, or (b) in respect to the title to be vested in the new corporation of any of the Sundstrand Corporation's property contemplated to be transferred as aforesaid, or (c) in respect to profits and the value of any of such Sundstrand Corporation's property, or if the Company in its investigation of the business of the Sundstrand Corporation shall find any facts or conditions which in the opinion of the Company may seriously and adversely affect the future prospects and business of the new corporation, the Company shall not be obligated to complete the organization of the new corporation or to otherwise carry out the purchase contemplated by this agreement.

73 "The Company agrees to proceed with due diligence to make the audit and investigation contemplated by the paragraph of this agreement next above.

"The new corporation may at its option use the name Sundstrand Corporation or Sundstrand as or as a part of its corporate name or that of any of its subsidiaries, and the Sundstrand Corporation will when and as requested by the new corporation or the Company make any necessary change in its corporate name or that of any of its subsidiaries or otherwise so that the new corporation and its subsidiaries may be in a position to register to do business in any state in the United States or elsewhere.

"Pending the time of transfer of the Sundstrand Corporation's property to the new corporation, the Sundstrand Corporation shall not, nor shall it permit any subsidiary company, to convey, encumber or otherwise dispose of any of its real estate, improvements or buildings thereon or other fixed assets or any of its patents, patent rights or license agreements, or declare, or pay any dividend or pay any bonus under any contract or contracts or other agreements between Sundstrand Corporation and Gustaf David Sundstrand or Oscar J. Sundstrand or any amount for any Federal Taxes, except approximately $12,000, being the last quarterly payment on 1925 Federal Taxes, or otherwise do any act or thing not in ordinary routine and usual conduct of the business without the written approval of the Company.

74 "The Sundstrand Corporation agrees to assume all liabilities for bonuses to the Sundstrand Brothers arising

from operations in 1926 and all liabilities for income and other taxes in connection with its 1926 profits and all liabilities for all taxes of whatever kind arising and to arise for all years previous thereto and is to be entitled to any refund in Federal or other taxes due or to become due the Sundstrand Corporation whenever receieved.

"If the Company shall be satisfied with the result of the audit and investigation agreed by it to be made as hereinabove provided then it shall so notify the Sundstrand Corporation in writing, and the transfers and payment contemplated to be made by this agreement shall be made on or before December 31, 1926, upon at least ten days previous notice in writing given by the Company to Sundstrand Corporation and such transfers and payment as hereinbefore provided shall be made at the office of the Company in New York City, provided, however, that if by reason of delay by the Sundstrand Corporation in complying with any of the provisions hereof, such audit and investigation is not completed so that such notice can be so given on or before December 20, 1926, the time for giving such notice and for making the transfer and payments hereinbefore provided shall be extended for the number of days equivalent to the length of such delay.

"The Company agrees to cause the new corporation to
75 have its books, accounts and records audited by some reputable firm of certified public accountants annually. The Company further agrees annually and within four months after the close of the Company's fiscal year to cause the new corporation to furnish to a representative of the preferred stockholders selected by them, a copy of a complete report prepared by such auditors. The Sundstrand Corporation shall notify the new corporation in writing prior to February 1, 1927, of the name and address of such representative and the new corporation shall be entitled to recognize such representative until a successor has been appointed in writing by the holders of a majority of such preferred stock then outstanding and the new corporation notified of the appointment of such successor.

"Any notice required hereunder to be given to Sundstrand Corporation shall be sufficiently given if and when deposited in the registered mail with all postage properly paid thereon, addressed to Sundstrand Corporation, Rockford, Illinois.

"This agreement is personal to the parties hereto, and it

shall not be assigned by either without the written consent thereto first obtained of the other, but it shall bind and enure to the benefit of the successors in business of the Sundstrand Corporation and the successors in the business of the Company.

"In Witness Whereof, the parties hereto have duly
76 executed this agreement the day and year first above written.

SUNDSTRAND CORPORATION
By (signed) W. A. BROLIN,
President.

Attest:
(Signed) HUGO L. OLSON
Secretary.

ELLIOTT-FISHER COMPANY
By (Signed) P. D. WAGONER
President.

Attest:
Signed C. S. DUNCAN
Secretary"

77 "EXHIBIT A.

Tentative Balance Sheet
As of Sept. 30—1926

Assets

Cash	$164,834.
Accounts Receivable	525,317.
Inventory	695,711.
Subsidiary Cos.	33,593.
Fixed Assets	984,662.
Deferred Charges	23,446.
Patents & Good Will	1,253,932.
	$3,681,495.

Liabilities	
Current Accounts	$ 69,060.
Accrued Charges	35,532.
Reserve—1925 Federal Taxes	12,787.
Service Contracts	4,116.
Notes Payable	160,000.
Tool Bldg. & Land	50,000.
	$ 331,495.
Capital & Surplus	3,350,000.
	$3,681,495.
Capital and Surplus	
12,500 Shares 7% Pfd.	$1,250,000.
30,000 Shares Common & Surplus	2,100,000.
	$3,350,000.

Book value of Sundstrand Canadian Company Ltd. as reflected by subsidiary Company books is greatly in excess of book value reflected on parent Company books. Parent Company book value used in above figures."

78 "EXHIBIT 3.

"Special Meeting of Stockholders

"Special Meeting of the Stockholders of the Sundstrand Corporation, held at the offices of said Corporation on Eleventh Street, in the City of Rockford, Illinois, at the hour of 7:00 o'clock P. M., on the 18th day of November, A. D. 1926, pursuant to call of the Board of Directors of said Corporation and notice sent by United States mail, postage prepaid, on the 8th day of November, A. D. 1926, to each of the Stockholders of record of said Corporation, which said notice was in the following form, that is to say:

'Notice of Special Meeting
Of Stockholders of Sundstrand Corporation

To _____

You Are Hereby Notified that pursuant to call made by the Board of Directors of this Corporation, a Special Meeting of the Stockholders of the Sundstrand Corporation will be held at the Company's office in the City of Rockford, Illinois, at 7 o'clock P. M., on Thursday the 18th day of November, A. D. 1926, for the purpose of considering and acting upon

a proposition made to this Corporation to sell and dispose of all of its property and assets and for the transaction of any and all business pertaining to the consideration of and action upon said proposal or necessary in connection therewith.

Dated, this 8th day of November, 1926.

HUGO L. OLSON
Secretary'

"W. A. Brolin, President, was present and presided, and Hugo L. Olson, Secretary, was present and acted as Secretary of the meeting.

"Upon roll-call of Stockholders of record of said Corporation, it was found that the owners of 14041 shares of the stock of said Corporation were present, either in person or by proxy.

"The President appointed John A. Nelson and George Lindblade to act as tellers.

"The President ordered the Secretary to submit to the meeting a proposed agreement between this Company and Elliott-Fisher Company which had been approved by the
79 Board of Directors of this Company, providing for a reorganization upon the terms and conditions therein stated and for the sale and transfer of all of the property and assets of this company.

"Upon motion duly made and seconded, said Agreement was ordered marked for identification and filed in the records of the Company.

"Mr. Eric Ekstrom thereupon proposed the adoption of the following Resolutions:

'Resolved that the Stockholders of the Company in meeting duly assembled hereby approve said Agreement, and authorize and direct the sale and transfer of all the property and assets of this Company upon the terms and conditions therein provided; and further

'Resolved that the Board of Directors and Officers of this company be and they hereby are authorized and directed to take such steps and to execute such instrument or instruments including said Agreement, with such modifications thereof or supplements thereto, as in their opinion may be necessary or desirable in order to effect such sale and transfer; and further

'Resolved, that upon the consummation of said reorganization and sale, the proceeds consisting of preferred capital stock and cash received from such sale be distributed im-

mediately to the stockholders in the order of their preferential rights, the preferred stock being first fully redeemed and the balance distributed to the common stockholders; and further

'Resolved, that this corporation, after the consummation of said re-organization and sale under the said agreement with Elliott-Fisher Company and the distribution of the proceeds in accordance with the reorganization plan to its stockholders in the manner provided above, shall cease operation, and the directors and officers thereof shall proceed to liquidate the corporation and cause the same to be dissolved.'

"Mr. Chas. Rystrom seconded the adoption of said Resolutions.

"A vote thereon was then taken by ballot and after a canvass of the vote, the President declared that 14041 shares of the capital stock of this company, being all of the shares represented at this meeting, had been voted for the adoption of said resolutions.

80 "The President then declared that said resolutions had been duly adopted by a unanimous vote of all of the stockholders present in person and represented by proxy and by the holders of more than two-thirds of all of the capital stock of this company issued and outstanding.

"For the purpose of being in a position to comply with one of the requirements in said proposed contract with said Elliott-Fisher Company, Mr. Hugo L. Olson, one of the stockholders of this corporation, presented and moved the adoption of the following resolution:

"Resolved that the name of this Corporation be and is hereby changed from Sundstrand Corporation to John A. Nelson Co.

"The adoption of said Resolution was seconded by Mr. Geo. F. Nelson, one of the stockholders of this corporation, and upon roll-call of the Stockholders, a unanimous vote was cast in the affirmative, for the adoption thereof.

"The President then declared said Resolution duly adopted by the requisite number of votes.

"Mr. Eric S. Ekstrom presented and moved the adoption of the following Resolution:

"Resolved, That we, the stockholders of this Company here assembled, express and convey to Mr. Hugo L. Olson, Secretary and Manager, and to his associates, our most sincere and hearty appreciation of the genuinely loyal and exceedingly efficient services which they have rendered to the

Company and its stockholders throughout the years of its existence and which have resulted in building up a remarkably successful business and establishing an eviable reputation for the Company's product.

"The motion to adopt said Resolution was seconded by Mr. T. E. Swords.

"On vote, the motion was unanimously carried and the Resolution declared adopted.

State of Illinois,
County of Winnebago } ss.

HUGO L. OLSON, being duly sworn, on oath states that he is now, and was on the 8th day of November, A. D. 1926, Secretary of the Sundstrand Corporation; that on the
81 said 8th day of November, 1926, he deposited in and sent by United States Mail, to each of the Stockholders of record of the said Sundstrand Corporation, inclosed in a sealed envelope, postage prepaid, addressed to his or her last known Post-office address, notice of a special meeting of the Stockholders of the said Sundstrand Corporation, to be held at Seven o'clock P. M., on the 18th day of Noyember, A. D. 1926, which said notice was in the following form:

Notice of Special Meeting

Of Stockholders of Sundstrand Corporation

To_____

You Are Hereby Notified that pursuant to call made by the Board of Directors of this Corporation, a Special Meeting of the Stockholders of the Sundstrand Corporation will be held at the Company's office in the City of Rockford, Illinois, at 7 o'clock P. M., on Thursday, the 18th day of November, A. D. 1926, for the purpose of considering and acting upon a proposition made to this Corporation to sell and dispose of all of its property and assets and for the transaction of any and all business pertaining to the consideration of and action upon said proposal or necessary in connection therewith.

Dated, this 8th day of November, 1926.

HUGO L. OLSON,
Secretary

HUGO L. OLSON (Signed)

Subscribed and sworn to before me, this 19th day of November, A. D. 1926.

JOHN A. NELSON (Signed)
(Seal) *Notary Public.*

"Upon Motion duly made, seconded and unanimously carried, the meeting was adjourned.

HUGO L. OLSON (Signed)
Secretary"

82 The foregoing is all of the material evidence adduced at the hearing before the United States Board of Tax Appeals, and the same is approved by the undersigned as attorney for the John A. Nelson Company.

J. S. SEIDMAN
J. S. Seidman

The foregoing is all of the material evidence adduced at the hearing before the United States Board of Tax Appeals, and the same is approved by E. Barrett Prettyman, General Counsel, Bureau of Internal Revenue, attorney for the Commissioner of Internal Revenue.

General Counsel, Bureau of Internal Revenue.

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The foregoing is all of the material evidence adduced at the hearing, and in order that the same may be preserved and made a part of this record, this statement of evidence is duly approved and settled this 10th day of January, 1934.

(S) CHARLES P. SMITH,
Member, United States Board of Tax Appeals.

ov. 30, 14 UNITED STATES BOARD OF TAX APPEALS.

John A. Nelson Company, formerly known as Rockford Milling Machine Company), *Petitioner,* *vs.* Commissioner of Internal Revenue, *Respondent.*	Docket Nos. 32986, 44700.

(Promulgated November 30, 1931.)

1. Distributions as "special compensation" to two inventors who together owned approximately 7½ per cent of petitioner's outstanding common stock, of "five per centum

(5%) of the net profits" of petitioner, held to be capital expenditures.

2. For 1918 to 1923, inclusive, petitioner filed returns on accrual basis. Its return for 1924 was timely filed on installment basis. Respondent approved such change and made refunds for 1918 to 1923, inclusive. Returns for 1925 and 1926, also, were made on installment basis. Held, that collections made in 1924, 1925 and 1926, on account of installment sales made prior to 1924, are not taxable as income in those years.

3. Held, under the circumstances here, that "unrealized profits" on installment sales are not taxable when, in 1926, petitioner as a party to a reorganization, transfers to the second party in such reorganization, substantially all its assets for stock of the second party and $2,000,000 in cash, when such stock and cash are immediately disposed of by petitioner in accordance with the plan of reorganization. *Charles F. Meagher,* 20 B. T. A. 68, followed.

F. E. Seidman, C. P. A., and J. S. Seidman, Esq., for the petitioner.

Brooks Fullerton, Esq., and John D. Kiley, Esq., for the respondent.

These proceedings are for the redetermination of deficiencies asserted by the Commissioner for the years 1924, 1925 and 1926, as follows:

Docket No.	Deficiency Notice dated:	Year	Amount
32986	October 19, 1927	1924	$24,573.08
32986	October 19, 1927	1925	6,145.70
44700	March 25, 1929	1926	45,855.03

In June, 1926, the Rockford Milling Machine Company (Docket No. 32986), changed its name, without change of corporate identity, to Sundstrand Corporation; and in December, 1926, again changed its name, without change of corporate identity, to John A. Nelson Company. The Board holds, therefore, that the John A. Nelson Company is the same corporate identity as the Rockford Milling Machine Company, and ordered that the name "John A. Nelson Company" be substituted in this proceeding for "Rockford Milling Machine Company," and that further proceedings be in accordance therewith.

In its petitions, original and as amended, petitioner asserts that the Commissioner has erred as below:

For 1924:

1. By capitalizing a bonus paid to designers in the amount of $13,481.06.

2. By including as profit $294,452.65 from collections on installment contracts covering sales of prior years.

For 1925:

3. By capitalizing a bonus paid to designers in the amount of $15,284.80.

4. By including $29,009.86 resulting from collections in 1925 on installment sales made prior to 1924.

16 For 1926:

5. By capitalizing a bonus paid to designers in the amount of $16,686.57.

6. By including $6,864.68 resulting from collections in 1926 on installment sales made prior to 1924.

7. By including in income $322,980.29, which amount represents the reserve for unrealized profit on installment sales.

From the Commissioner's determinations as shown by the deficiency notices, timely appeal was taken to the Board, and the cases were consolidated for hearing and decision.

The cases thus consolidated were submitted upon stipulation and briefs. No witnesses were examined, nor was oral argument made. From the stipulation we make the following

FINDINGS OF FACT.

Petitioner is an Illinois corporation, with its principal office at Rockford, Illinois. It is now inactive, but during the years 1924 to 1926, inclusive, it was engaged in the manufacture and sale of milling and adding machines under the name of Rockford Milling Machine Company. In June, 1926, the name of the corporation was changed from Rockford Milling Machine Company to Sundstrand Corporation. In December, 1926, its name was changed to John A. Nelson Company.

17 Petitioner kept its books and prepared its returns on the accrual basis, except for the years prior to 1924, as will appear later.

In December, 1923, petitioner entered into a contract with Gustaf David Sundstrand and Oscar J. Sundstrand, the material parts of which contract, stipulated in substance, are as follows:

The document is captioned "Contract—General Agreement with Inventors" and is a memorandum of agreement between Gustaf David Sundstrand and Oscar J. Sundstrand, parties of the first part, and Rockford Milling Machine Company, a corporation, party of the second part.

It stipulates that the company's entire product consists of machines invented by the parties of the first part, some of which inventions had been patented by letters patent, both domestic and foreign, and as to others, patents had been applied for in all of about twenty inventions, the latest being dated January 9, 1922.

It is stipulated that parties of the first part may invent other devices and improvements on machines then in use, and provides that all such new inventions should be disclosed to and assigned to the party of the second part without further costs. The consideration named in the contract is one dollar, and the mutual promises in said contract set forth.

It stipulates that the party of the second part agrees to pay to the parties of the first part, their legal representatives and assigns, 5 per cent of the net profits of the company from any and all sources, it being understood that if the company should add to its lines machines or articles not invented by the parties of the first part which contribute a substan-
18 tial portion of the company's net profits, such portion shall be excluded in calculating the percentage due to the parties of the first part. Such 5 per cent payments are made payable on an annual basis.

The term of the agreement is stipulated to run from January 1, 1923, to the end of the term of the last to expire of the United States letters patent granted to Rockford Milling Machine Company under this agreement, it being understood that in the event the Rockford Milling Machine Company should assign its business to another, such assignee should assume the liabilities in favor of parties of the first part, and the term should be to the last expiring date of the patents granted to such assignee on inventions of the parties of the first part.

As a part of the contract, there is a draft of a resolution to be passed by the petitioner's board of directors in connection with the contract, which draft was made a part of the contract. The resolution was passed in the same language as the draft at a meeting of petitioner's board of directors held on December 31, 1923.

All the patents and applications for letters patent mentioned in the "Whereas" clauses had been issued to petitioner or acquired by assignment from Gustaf David Sundstrand and Oscar J. Sundstrand on or before the dates of the respective letters patents or applications. Both Sundstrands were in the employ of petitioner throughout all the years in-

volved, and also throughout the taxable years in ques-
19 tion. They worked on the inventions during business hours and conducted their experiments with petitioner's tools and materials. The petitioner had paid and borne all costs of developing, securing, prosecuting, and defending said patents and applications. On December 31, 1923, Gustaf David Sundstrand owned 351 shares and Oscar J. Sundstrand owned 260 shares of a total of 8,250 shares of outstanding common stock of petitioner, each share having a par value of $100 each.

The amounts paid by petitioner under the contract for the years 1924 to 1926, inclusive, were $15,827.68, $19,371.18 and $23,030.83.

Petitioner deducted said amounts in its returns for the years mentioned as compensation for services.

The respondent considered each of these amounts as a capital expenditure, applicable equally to each of the United States patents set forth in the contract. The respondent allowed as a deduction by way of amortization of these amounts (and the amount of $11,516.56 paid by petitioner for the year 1923) $1,289.63 for 1924, $1,739.76 for 1925, and $6,344.26 for 1926, computed on the basis of the remaining life of each of these patents at the end of the years 1924 to 1926, inclusive. The respondent accordingly disallowed as deductions in this respect, $13,481.06 for 1924, $15,284.80 for 1925, and $16,686.57 for 1926.

In its returns for the years prior to 1924, petitioner's net income was not computed on the installment method. In
20 its original return for the year 1924, filed prior to February 26, 1926, it changed its method of reporting net income to an installment basis, and the respondent approved thereof. Respondent then recomputed petitioner's income for the years 1918 to 1923, and refunded to petitioner for the years 1918 to 1923, inclusive, the excess (of tax as returned and paid on the accrual basis) above the tax as shown by said recomputation on the installment basis. Petitioner likewise reported on an installment basis in its original returns for the years 1925 and 1926, and the respondent approved thereof.

In such return for the year 1924, the petitioner excluded, in computing income, amounts received during 1924 on account of installment sales made prior to 1924. The respondent, in determining the present deficiency, added to petitioner's income the amount of $294,452.65 based on amounts re-

ceived during 1924 on account of installment sales made prior to 1924.

In such return for the year 1925, petitioner excluded, in computing income, amounts received during 1925 on account of installment sales made prior to 1924. The respondent, in determining the present deficiency, added to petitioner's income the amount of $29,009.86 based on amounts received during 1925 on account of installment sales made prior to 1924.

21 In the return for the year 1926, petitioner included, in computing income, $6,864.68 as profits received by petitioner during 1926 on account of installment sales made prior to 1924. Respondent made no change in petitioner's 1926 return in respect of profits received by petitioner during 1926 on account of installment sales made prior to 1924.

On December 31, 1926, petitioner was a party to a reorganization, pursuant to the plan of which it transferred substantially all of its properties to the Sundstrand Corporation of Delaware in exchange for 14,060 shares of the preferred stock of the Delaware Corporation, and $2,000,000 cash. Petitioner immediately used part of the cash so received to retire its own preferred stock and immediately distributed the preferred stock and the balance of the cash so received to its own stockholders, pursuant to the reorganization plan. The contract and corporate minutes relative to such reorganization, provide in substance:

Date of agreement November 18, 1926.

The agreement was between Sundstrand Corporation and Elliott-Fisher Company, a Delaware corporation. The stipulated consideration is one dollar and mutual agreements.

Sundstrand Corporation represents that it owns the entire adding machine business formerly operated under the corporate name of Rockford Milling Machine Company, and will presently acquire other designated property. The contract stipulates that the Elliott-Fisher Company shall cause a new corporation to be organized having a presently issued capital stock of:

(a) 12,500 shares of $7 preferred stock, par value $100.

22 (b) 30,000 shares of common stock, no par value.

Additional preferred stock, for specific purposes was authorized.

The Sundstrand Corporation obligated itself to convey to the new corporation all its assets, including patent accounts and notes receivable, to the new corporation, reserving out.

however, $100,000 in cash. The new corporation assumed all the ordinary obligations of the Sundstrand Corporation. The new corporation, in payment for the assets so transferred, issued and delivered to the transferor 14,060 shares of its preferred stock and $2,000,000 in cash.

No gain or loss was recognized or reported by petitioner in its 1926 return with respect to amounts received by petitioner during 1926 on account of installment sales made prior to 1924. Petitioner's treatment was approved by the respondent, except as set forth next below.

As of December 31, 1926, the books of petitioner showed a reserve for "Unrealized Profit" on installment sales in the amount of $322,980.29. The respondent added to petitioner's income, in arriving at the deficiency here in question, the $322,980.29, on the ground that the petitioner collected, when it exchanged its assets for stock and cash, 100 per cent for the total outstanding installment accounts receivable. Included in the $322,980.29 is an amount of $1,640.49 representing uncollected profits on sales made prior to 1924. This amount of $1,640.49 is not included in the amount of $6,864.68 referred to above as profits received by petitioner during 1926 on account of installment sales made prior to 1924.

23 OPINION.

LOVE: The direct issues are three:

1. Whether the amounts paid to the Sundstrands (who were two inventors) for their work in the inception and development of patents, are deductible as expenses, or whether they they should be capitalized as a part of the cost of such patents.

2. Whether collections from sales made prior to 1924 on the so-called accrual basis, may be included in income for 1924, 1925 or 1926, when the collections were made, during which years petitioner was reporting on the installment basis.

3. Whether taxable gain was realized in 1926, when a reorganization occurred from a transfer of installment accounts maturing in subsequent years.

To these direct issues, respondent adds the query whether, for 1924 and 1925, the evidence in the record is sufficient to enable the Board to redetermine petitioner's correct tax liability for those years.

Respondent contends in respect of the years 1924 and 1925, that petitioner has not adduced evidence showing its income

for those years (a) as reported on returns, (b) with changes made by the Commissioner, and (c) as corrected by the Commissioner. Counsel for respondent asserts that the determination of the Commissioner is presumed to be correct, and that the burden of proof is on petitioner to show that the Commissioner is wrong, and that petitioner must show what its correct tax liability is.

24 To clear the way for the consideration of the other issues, we will first dispose of these contentions as applied to this case by denying them. There is no dispute between the parties in regard to the above matters and they are not at issue. The only things that the Board is undertaking to determine in the first instance are the questions at issue. Those once determined by the Board, the "redetermination" of the deficiency and the settlement, follow under Rule 50 of the Board's Rules of Practice, which rule provides, and is intended to provide for, among other things, just such situations as we have here. It would be supererogatory for the Board to consider matters about which the parties are not in dispute. We conceive that we shall have no difficulty, occasioned by lack of evidence, in reaching conclusions in regard to the issues which are before us.

The first of these as we have set them out above, is in regard to the amounts paid to the Sundstrands for their work on the patents.

On December 31, 1923, a written agreement was entered into by and between Gustaf David Sundstrand and Oscar J. Sundstrand, parties of the first part, and petitioner (then known as the Rockford Milling Machine Company), party of the second part, by which provision was made in accordance with a pre-existing "oral understanding," for the assignment to petitioner which had been made by them prior to the date of the written agreement, of "the entire right, title and interest" in eighteen applications for letters patent of the United States, the latest bearing date of January 9, 1922, and eight applications for foreign letters patent, the lat-

25 est, according to the record, being dated January 8, 1921, the assignment "including foreign patent rights" not otherwise specified.

In accordance with the provisions of this agreement and the other facts as we have found them, we hold that these disbursements in 1924, 1925 and 1926, of "five per centum (5%) of the net profits of the company" for each year immediately preceding that in which the distribution was made, were cap-

ital expenditures for property acquired, and as such property, subject to depreciation over the 17-year life of each patent concerned. This rule has been consistently followed by the Board. See *Individual Towel & Cabinet Service Co.*, 5 B. T. A. 158, and cases therein cited. See also *Stephens-Adamson Manufacturing Co.*, 16 B. T. A. 41, confirmed by the Circuit Court of Appeals for the Seventh Circuit, decided July 27, 1931, and reported in 313 C. C. H., p. 8921. On this issue the Commissioner is sustained.

The second question for our determination is the inclusion in taxable income for the years 1924, 1925 and 1926, of collections on installment sales made prior to 1924.

From 1918 to 1926, inclusive, petitioner sold personal property on the installment plan. For 1918 to 1923, inclusive, petitioner reported its income on the accrual basis. In its original return for 1924, petitioner changed its method of reporting income to the installment basis. For 1925 and 1926, also, its returns were prepared on the installment basis. There is no question raised as to the propriety of making the returns on the installment basis, the change from the accrual to
26 the installment basis being authorized by section 212 (d) of the Revenue Act of 1926, as that section was made retroactive by section 1208 of the same Act.

In accordance with the statute, and the regulations thereunder (Article 42 of Regulations 69), petitioner made application for and obtained a refund, for the years 1918 to 1923, inclusive, for the excess tax as returned on the accrual basis and paid for those years, above the tax as shown by recomputation on the installment basis.

In reporting income received for 1924, petitioner, in its return, excluded as being derived from installment sales made prior to January 1, 1924, receipts amounting to $294,452.65. The Commissioner increased petitioner's reported income by that amount.

In reporting income received for 1925, petitioner, in its return, excluded as being derived from installment sales made prior to January 1, 1924, receipts amounting to $29,009.86. The Commissioner increased petitioner's reported income by that amount.

In reporting income for 1926, petitioner, in its return, included receipts derived from installment sales made prior to January 1, 1924, in the amount of $6,864.68. The Commissioner has made no adjustment in connection with that amount.

Petitioner contends that the Commissioner's action in thus increasing its reported income for 1924 and for 1925, and the Commissioner's failure to decrease its reported income for 1926, is in conflict with section 705 of the Revenue Act of 1928, which follows:

27 Sec. 705. Installment Sales—Retroactive.

(a) If any taxpayer by an original return made prior to February 26, 1926, changed the method of reporting his net income for the taxable year 1924 or any prior taxable year to the installment basis, then, if his income for such year is properly to be computed on the installment basis—

(1) No refund or credit of income, war-profits, or excess-profits taxes for the year in respect of which the change is made or any subsequent year shall be made or allowed, unless the taxpayer has overpaid his taxes for such year, computed by including, in computing income, amounts received during such year on account of sales or other dispositions of property made in any prior year; and

(2) No deficiency shall be determined or found in respect of any such taxes unless the taxpayer has underpaid his taxes for such year, computed by excluding, in computing income, amounts received during such year on account of sales or other dispositions of property made in any year prior to the year in respect of which the change was made.

(b) Nothing in this section shall be construed as in any manner modifying section 607, 608, 609 or 610 of this Act, relating to the effect of the running of the statute of limitations.

The provisions of this section apply to all the years in controversy. We are in substantial accord with the opinion of the General Counsel of the Bureau of Internal Revenue as it is expressed in his memorandum 8144, (recorded in C. B. IX-1, p. 173).

28 In the course of his memorandum, the General Counsel analyses the somewhat involved syntax of section 705, and he expresses the opinion, in conclusion, that:

> • • • where a taxpayer properly qualifies under section 705 of the Revenue Act of 1928, in determining deficiencies against the taxpayer there should be excluded in computing income for the year of change to the installment basis and for all subsequent years, amounts received on account of sales or exchanges of property made in years prior to the year of change, and that such procedure should be followed not only for the years involved

> * * * but also for years covered by the Revenue Act of 1928. * * *

Respondent does not apply this opinion of the General Counsel in the instant case. He contends that section 705, quoted *supra*, was enacted solely as a relief measure from double taxation which might result from the operation of the law as construed by the Board in *Blum's, Incorporated*, 7 B. T. A. 737, and that petitioner, having received refunds for 1918 to 1923, inclusive, as provided in section 1208 of the Revenue Act of 1926, is not a taxpayer who "properly qualifies under section 705 of the Revenue Act of 1928." Quoting respondent, he says that:

> Since petitioner, on account of the refund, has not been taxed on the profits which are included in the installment payments on sales of prior years collected in 1924, 1925 and 1926, the action of the Commissioner in including those profits in income for those years does not subject the petitioner to double taxation. Petitioner is not within the purview of the relief provision of section 705 of the 1928 Act and the Commissioner's action in taxing
> 29 the profits as received was correct. * * * The petitioner having two methods of relief available has taken full advantage of one, and has not been subjected to double taxation. Now the petitioner wishes to invoke the other method in his favor and to escape taxation on income which in equity and good conscience should be taxed. Such was not the intent of Congress * * *.

That such is the precise result that will ensue, if we support petitioner's contentions, is obvious, and it may even be admitted that the entire probability supports respondent's contention that such was *not* the intent of Congress, but where the mandate of a statute is clear and free from ambiguity, there are no sufficient grounds for this Board to disregard the statutory provisions merely because in a particular case the application of the statute appears to result in an inequitable or incongruous situation. There is nothing in the statute to indicate that section 705 is purely a "relief measure" available only to those taxpayers who have not received refunds under the other provisions of earlier Acts. We are not here concerned whether "in equity or good conscience" these amounts in question should be taxed. In our judgment the unmistakable mandate of the statute is that they shall not be taxed, and we so hold.

The two preceding issues are raised in all three of the taxable years in question. The third issue applies only to the

last of them, the year 1926. On December 31, of that year, petitioner was a party to a reorganization, and pursuant to the reorganization plan, it transferred substantially all of its properties to the Sundstrand Corporation of Delaware in exchange for 14,060 shares of the preferred stock of the Delaware corporation, and $2,000,000 cash. Petitioner immediately used part of the cash so received to retire its own preferred stock, and still pursuant to the reorganization plan, immediately distributed to its own stockholders the preferred stock of the Delaware corporation, and the remainder of the cash. As of the same date (December 31, 1926) petitioner's books of account showed a reserve for "Unrealized Profit" on installment sales in the amount of $322,980.29. In arriving at the proposed deficiency here in question, respondent added this amount to petitioner's income, on the ground that when petitioner exchanged its assets for stock and cash, it collected 100 per cent of the total outstanding installment accounts receivable. Included in the $322,980.29 is an amount of $1,640.49 representing uncollected profits on sales made prior to 1924, but such $1,640.49 is not included in the amount of $6,864.68 referred to above as profits received by petitioner during 1926 on account of installment sales made prior to 1924.

The question raised is whether the amount of $322,980.29 or any part thereof, is income to petitioner in 1926.

In one form or another, this question has been before the Board upon earlier occasions, and we have considered it as it was presented in the several cases decided. See *Packard Cleveland Motor Co.*, 14 B. T. A. 118; *R. L. Brown*, 14 B. T. A. 609; *Wallace Huntington*, 15 B. T. A. 851; *M. A. Milan*, 16 B. T. A. 1112; *Charles F. Meagher*, 20 B. T. A. 68; *Lucius H. Elmer*, 22 B. T. A. 224; and *Virginia Beach Golf Course Annex Corporation*, 23 B. T. A. 1169.

The pertinent parts of the 1926 Act, which governs here, are:

Sec. 203 (b) (3) No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization • • •

(e) If an exchange would be within the provisions of paragraph (3) of subdivision (b) if it were not for the fact that the property received in exchange consists not only of stock or securities permitted by such paragraph

to be received without the recognition of gain, but also of other property or money, then—

(1) If the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange, * * *

We have closely scrutinized the facts in the case at bar, the Act relating thereto, and the earlier decisions of the Board. The case most closely paralleling the one now before us is *Charles F. Meagher, supra.* The *Meagher* case fell under the provisions of the Revenue Act of 1921, but the Act of 1926, applicable here, though it differs from the earlier Act in the phraseology of some of its provisions, differs in no material respect therefrom in the effect of the sections above quoted, as we read and apply them, nor does respondent contend that it does. The 1926 Act is even more definite and free from ambiguity than the Act of 1921. In the *Meagher* case we said:

We can but conclude that the transfer by petitioner of these installment obligations in a transaction which, under existing law is held not to result in taxable gain, can not be considered as a present realization of income therefrom, and this conclusion is further strengthened
32 by the fact that the determining of a taxable gain from such a transaction is first provided for by the Revenue Act of 1928 in Section 44 (d), * * *

This section is not by its terms made retroactive and, as we pointed out in *Wallace Huntington, supra,* the insertion of this new provision in that act was clearly indicated by the report of the Committee on Finance of the Senate, and the Committee on Ways and Means of the House of Representatives, to be for the purpose of changing the condition existing under the prior revenue acts, including the Revenue Act of 1921 [and the Revenue Act of 1926] here involved, under which it was possible to dispose of installment obligations in a transfer not giving rise to loss or gain and thereby evade tax liability in respect to the income which would otherwise be represented by them.

We are controlled by the *Meagher* case from which we have just quoted, and by *Wallace Huntington, supra.* Accordingly, we hold that no taxable profit was realized by petitioner when in 1926 it transferred to the Sundstrand Corporation of Delaware substantially all of its properties (in-

cluding installment accounts receivable) in exchange for 14,060 shares of the preferred stock of the Delaware corporation, and $2,000,000 in cash.

The amount of $1,640.49 representing uncollected profits on sales made prior to 1924, included in the total amount of $322,980.29, is exempt from taxation under our decision on the second issue herein considered.

JUDGMENT WILL BE ENTERED UNDER RULE 50.

33 • • (Caption—32986 and 44700) • • Entered D 1931.

ORDER.

Pursuant to section 601 (b) of the Revenue Act of 1928 it is directed that the division report in the above entitled proceedings, promulgated November 30, 1931, shall be reviewed by the Board.

(Signed) LOGAN MORRIS,
Chairman.

Dated: Washington, D. C. December 19, 1931.

34 • • (Caption—32986 and 44700) • • • Entered A 1932.

ORDER.

The above styled and numbered proceeding was submitted, under properly executed stipulations, on June 26, 1930, subject to the filing of briefs at a later stipulated date.

Such briefs were duly filed, and the case considered under said stipulations and in view of such briefs.

It was specifically stipulated by the parties, petitioner and respondent, that "On December 31, 1926, petitioner was a party to a reorganization." The question as to whether or not petitioner was a party to a reorganization is vital to one of the major issues in the case.

That question is controlled by section 203 (h) and 203 (i) of the Revenue Act of 1926.

35 In view of the fact that the record discloses facts, particularly the fact that the 30,000 shares of common stock of the transferee corporation, was not held, after such transfer, by the petitioner or its stockholders, which facts unex-

plained in any way, preclude the conclusion that there was a reorganization as contemplated by the statutes cited, the Board is of the opinion that it is not justified in accepting the stipulation of the parties. It is therefore

Ordered that the prior submission of said proceeding be and hereby is set aside and the case reopened for further hearing in Washington, District of Columbia, on May 25, 1932, at 10 o'clock A. M., at which time such pertinent evidence as may be offered by either party on the question of whether or not the petitioner was a party to a reorganization as a result of the deals effected in December 1926, will be received.

(Signed) WILLIAM D. LOVE,
Member United States Board of Tax Appeals.

Dated: Washington, D. C. April 13, 1932.

36 • • (Caption—32986 and 44700) • •

(Stamped) Received Aug 10 1932 U. S. Board of Tax Appeals.

MOTION TO VACATE ORDER.

Filed Aug. 10, 1932.

Comes now the petitioner, by J. S. Seidman, its counsel, and moves this honorable Board to vacate its order dated April 13, 1932, setting aside the prior submission of the case and reopening it for further hearing. In this respect petitioner sets forth the following:

This proceeding was submitted under properly executed stipulations on June 26, 1930, subject to the filing of briefs. Such briefs were duly filed, and the case considered under the stipulations and in view of the briefs. On November 30, 1931 a division report was promulgated which embodied the stipulations in the Findings of Fact and the related Opinion of the division. On December 19, 1931 an order was entered by the Board on its own motion directing that the division report be reviewed by the entire Board. On April 13, 1932, again on its own motion, the Board entered the order here requested to be vacated.

It was specifically stipulated by the parties that "on De-

cember 31, 1926 petitioner was a party to a reorganization".
(The question as to whether or not petitioner was a party
37 to a reorganization is vital to one of the major issues
in the case.) The order of the Board of April 13, 1932, in effect, refuses to accept the stipulation of the parties in respect to the quoted sentence.

Petitioner respectfully submits that this action on the part of the Board is legally untenable and unjustifiable. When the parties to a proceeding stipulate certain ultimate facts, it does not lie in the mouth of the judicial tribunal to say that those are not the facts; nor can the tribunal be heard to say that by reason of other things in the stipulation it doubts whether the ultimate facts therein set forth should have been stipulated and calls for outside evidentiary facts in support of the stipulation.

The parties to a proceeding are presumed to be represented by competent counsel and to be acting in good faith. It is not the function of the tribunal to act as their guardian angel. The office of the tribunal is solely that of deciding the issues on the record made. Where (as here) the parties have painstakingly developed the record by stipulations and have agreed upon an ultimate fact that was never in issue, it is obviously subversive of the sound administration of justice for the tribunal (except on a question such as jurisdiction) to overturn the record, and provoke strife on phases as to which the parties are at peace.

The Board was designed to decide issues, not create them. When, however, it reaches out into new pastures and assumes the role not only of referee but also combatant, it transcends its legal province and takes on a wholly unjustifiable status. It destroys entirely the sanctity of the ju-
38 dicial atmosphere and instead throws confusion into the ranks, with resulting incalculable mischief, by foisting a third party into an exclusively two-party affair.

Such is the havoc wrought in the present case. Both sides have solemnly advised the Board that petitioner was a party to a reorganization and that the Board can decide the case with that fact assumed and assured. Both sides have briefed the case and presented their views based on the sacredness of the facts they have agreed upon. Yet the Board, of its own accord, ordains that a tempest rage where the parties have found a haven in the calm of their stipulated ultimate facts. Clearly such visitation on the part of the Board is le-

gally untenable and unjustifiable. For helpful adjudications in this respect, see:

Hackfield & Co. v. *United States*, 197 U. S. 442, 446-7.
Arkansas Valley Sugar Beet & Irrigated Land Co. v. *Fort Lyon Canal Co.*, 173 Fed. 601, 603.
Seattle, L. S. & E. Ry. Co. v. *Union Trust Co.* 79 Fed. 179, 188, Citing *Lewis* v. *Sumner*, 13 Metc. (Mass.) 269.
United States v. *Davison*, 1 Fed. (2nd) 465, 470.

Wherefore petitioner prays that the Board grant this motion to vacate the order dated April 13, 1932 and that the case stand as originally submitted

J. S. SEIDMAN,
J. S. Seidman.
Counsel for Petitioner,
2 Lafayette Street,
New York City.

Dated, August 9, 1932.

Aug. 19, 39 * * (Caption—32986 and 44700) * *

ORDER.

It is hereby

Ordered that the motion filed August 10, 1932, with the Board by the petitioner in the above-entitled proceeding, requesting that "this honorable Board vacate its order dated April 13, 1932, setting aside the prior submission of the case and reopening it for further hearing," be and the same is hereby set for hearing September 14, 1932, at Washington, D. C.

(Signed) WILLIAM D. LOVE,
(Seal) *Member, United States Board of Tax Appeals.*

Dated Washington, D. C. August 19, 1932.

May 31, 40 * * (Caption—32986 and 44700) * *

ORDER.

On August 10, 1932, the petitioner filed a motion requesting that the Board vacate "its order dated April 13, 1932, setting aside the prior submission of the case and reopening it for further hearing," alleging that the Board's action therein

was "legally untenable and unjustifiable." Careful consideration has been given to the merits of this motion and the effect it has upon the disposition of these proceedings. The premises considered, it is

Ordered that the petitioner's motion be and the same is hereby denied.

(Signed) CHARLES P. SMITH,
Member.

(Seal)

Enter: May 31, 1933.

41 * * (Caption—32986 and 44700) * * Filed M 1933.

MEMORANDUM SUR ORDER.

The above entitled proceedings, duly consolidated, were submitted upon a written stipulation, and a division report, based upon the said stipulation, was promulgated November 30, 1931.

Section 601 (b) of the Revenue Act of 1928 provides that—

"The report of the division shall become the report of the Board within 30 days after such report by the division, unless within such period the chairman has directed that such report shall be reviewed by the Board. * * *

In accordance with the statute, the chairman entered an order on December 19, 1931, directing that the division report "be reviewed by the Board."

On April 13, 1932, the Board, upon its own motion, entered an order setting aside "the prior submission" and reopening the case. In the order, by way of premise therefor, we said:

42 "It was specifically stipulated by the parties, petitioner and respondent, that 'On December 31, 1926, petitioner was a party to a reorganization' The question as to whether or not petitioner was a party to a reorganization is vital to one of the major issues in the case.

That question is controlled by section 203 (h) and 203 (i) of the Revenue Act of 1926.

In view of the fact that the record discloses facts, particularly the fact that the 30,000 shares of common stock of the transferee corporation, was not held, after such transfer, by the petitioner or its stockholders, which facts unexplained in any way, preclude the conclusion that there was a reorganization as contemplated by the statutes cited, the Board is of the opinion that it is not justified in accepting the stipulations of the parties. * * *"

On August 10, 1932, the petitioner filed a motion requesting the Board "to vacate its order dated April 13, 1932, setting aside the prior submission of the case and reopening it for further hearing." On September 14, 1932, a hearing was had upon the petitioner's motion, at which time both parties were given an opportunity to, but neither did, offer further evidence with respect to the question of whether the petitioner was a party to a reorganization; this opportunity was given in accordance with the Board's order which the petitioner seeks to have set aside. Subsequently to the hearing upon the petitioner's motion, counsel for the petitioner filed a brief in which he argued *in extenso* that the stipulation of the parties that the petitioner was a party to a reorganization was binding upon the Board, and that in any event the petitioner was a party to a reorganization. The arguments advanced upon the first point all go to the binding effect of the stipulation of an ultimate fact, whereas, here, we are refusing to accept the stipulation of a legal conclusion, to-wit, whether under the statute this petitioner was a party to a reorganization. In *Jamison Coal & Coke Co.*, 24 B. T A. 554, 556, we said:

"• • • Stipulations can relate only to facts. We can not recognize or give effect to stipulations of law. (Citing authorities)."

The Board's action in entering the order of April 13, 1932, was within its sound discretion and the petitioner's motion is properly denied. See *Garden City Feeder Co.*, 27 B. T. A. 43 ——, promulgated April 10, 1933, for a full consideration of such matters The argument advanced with respect to the question of whether the petitioner was a party to a reorganization will be considered in the report upon the case.

Regardless of the Board's jurisdiction to reopen cases, and notwithstanding petitioner's arguments to the contrary, the statute (section 601 (b) of the Revenue Act of 1928) specifically provides that "The report of a division shall not be a part of the record in any case in which the chairman directs that such report shall be reviewed by the Board." The division report which the chairman ordered reviewed by the Board is therefore no longer a part of the record. The instant report has been prepared upon the basis of the stipulated facts, but by ignoring the legal conclusion as to whether or not the petitioner was a party to a reorganization.

(Signed) CHARLES P. SMITH
Member.

Enter: May 31, 1933.

44 • • (Caption—32986 and 44700) • • Filed Ju 1933.

Promulgated June 23, 1933.

1. Extra compensation based upon a percentage of annual net profits paid to two employees, from whom petitioner had acquired numerous patents and applications for letters patent, held, in the circumstances, to be deductible in the year in which paid.

2. By an original return filed for 1924, the petitioner changed from the accrual to the installment basis of reporting income. The Commissioner adjusted petitioner's returns for several prior years to the installment basis and refunded the difference in the amount of tax paid upon the accrual basis and the amount computed upon the installment basis. In these circumstances, held, the Commissioner properly included in the incomes of 1924, 1925, and 1926, the amount of the collections in those years upon installment sales made prior to 1924.

3. In 1926, in a taxable transaction, the petitioner disposed of its installment sales contracts. Held, the petitioner realized at that time the deferred profit upon such contracts and the amount of the then realized profit was properly included in its taxable income for 1926.

J. S. Seidman, Esq., and F. E. Seidman, C. P. A., for the petitioner.

Brooks Fullerton, Esq., John D. Kiley, Esq., and J. E. Marshall, Esq., for the respondent.

These proceedings, duly consolidated, are for the redetermination of the following income tax deficiencies:

Docket No.	Year	(Seal) Deficiency
32986	1924	$24,573.08
Do	1925	6,145.70
44700	1926	45,855.03

The pleadings, as amended, raise the following issues: (1) Whether the Commissioner erred by capitalizing alleged bonus payments to designers; (2) whether the Commissioner erred in including in taxable income of the respective years the collections in those years on installment sales made prior to 1924; and (3) whether the Commissioner "in computing the tax liability for the calendar year 1926 has erroneously increased income in the amount of $322,980.29, which amount

represents the reserve for unrealized profit on installment sales." The facts were stipulated.

Findings of Fact.

The petitioner is an Illinois corporation, with its principal office at Rockford. During the taxable years 1924, 1925, and 1926 the petitioner, under the name of Rockford Milling Machine Co., was engaged in the manufacture of milling and adding machines. In June 1926, the name of the taxpayer was changed to Sundstrand Corporation, and in December 1926, its name was changed to John A. Nelson Co.

In December 1923, the petitioner entered into a contract with Gustaf David Sundstrand and Oscar J. Sundstrand, which was designated as "General Agreement With Inventors." In so far as material here, the contract is as follows:

Whereas, the Company's entire product consists of machines invented and designed by the parties of the first part; and,

Whereas, the below mentioned United States patents have been granted to the Company on inventions made by the parties of the first part: [Here follows list of nine patents.]

Whereas, the below-mentioned foreign patents have been granted to the Company on inventions made by the parties of the first part: [Here follows list of eight patents.]

and

Whereas, the parties of the first part have filed applications for letters patent of the United States, which applications may be identified in the U. S. Patent Office as follows: [Here follows list of 18 applications for letters patent.]

and

Whereas the parties of the first part have filed applications for foreign letters patent as follows: [Here follows list of eight applications for letters patent.]

and

Whereas the parties of the first part have assigned the entire right, title and interest in said applications, including foreign patent rights, to said Company with the oral understanding that an agreement should be arrived at for the payment of special compensation to the parties of the first part; and

Whereas the parties of the first part have invented other improvements in milling machines, link grinders, adding, listing and calculating machines and cash registers; and

Whereas the parties of the first part may make further in-

ventions and improvements relating to the lines of machinery manufactured by the Company;

and

45 Whereas, said Company desires to acquire all such inventions and improvements relating to the lines of machinery manufactured by the Company which may be made by the parties of the first part during the term of this agreement * * *;

Now, Therefore, in consideration of the promises and of their mutual promises herein set forth and of the payment of One Dollar to the parties of the first part, by said Company, the receipt and sufficiency of which considerations are hereby acknowledged, the parties hereto have agreed together as follows, to wit:

1. The parties of the first part hereby agree to disclose to said Company all inventions relating to milling machines, link grinders, double end lathes, adding, listing and calculating machines and cash registers * * * which they or either of them have heretofore made or may hereafter make during the term of this agreement; to execute at any time upon request, without further or additional consideration, but at the expense of said Company, applications for original, divisional, renewal, reissue or extended letters patent of the United States or of any and all foreign countries on such inventions; to assign the entire right, title and interest in and to all such inventions to said Company; and to render all necessary assistance in making application for and in obtaining such letters patent, and in enforcing any rights or choses in action accruing as a result of such applications or patents, by giving testimony in any proceedings or transactions involving such applications or patents, and by executing preliminary statements and other affidavits.

2. The company agrees to pay to the parties of the first part, their legal representatives or assigns, five per centum (5%) of the net profits of the Company from any and all sources, * * *

* * * * * *

8. The term of this agreement shall be from and including January 1, 1923, to the end of the term of the last to expire of the United States letters patent granted to said Rockford Milling Machine Company under this agreement, it being understood that if the business of said Company shall be divided as provided for in Paragraph 7 hereof, the obligations of said first parties and of the new corporation set forth in

said paragraph shall continue to the end of the term of the last to expire of the letters patent assigned or granted to such corporation in accordance with Paragraph 1 hereof.

9. This agreement shall bind and inure to the benefit of the successors, legal representatives and assigns of the parties hereto.

All of the patents and applications for letters patent referred to in the above agreement had been assigned to the petitioner by the Sundstrands, who were in the employ of the petitioner at all times material to our determination. The Sundstrands worked on the inventions during business hours and conducted their experiments with petitioner's tools and materials. The petitioner had paid and borne all costs of developing, securing, prosecuting, maintaining, and defending the several patents and applications for letters patent.

On December 31, 1923, Gustaf David Sundstrand owned 351 shares and Oscar J. Sundstrand owned 260 shares of a total of 8,250 shares of petitioner's outstanding common stock of the par value of $100 per share.

For the taxable years before us, the petitioner, under the contract, paid the Sundstrands, and in its returns for these years deducted, as compensation for services rendered, the following amounts:

1924	$15,827.68
1925	19,371.18
1926	23,030.83

The respondent disallowed the claimed deductions. The respondent capitalized these payments, to which he added a similar payment for 1923, and has applied the capital expenditure equally to the several United States patents referred to in the contract. Upon the basis of the remaining term of each of these patents at the end of the respective years, the respondent has allowed deductions for the amortization of these expenditures as follows:

1924	$1,289.63
1925	1,739.76
1926	6,344.26

The petitioner kept its books and prepared its income tax returns on the accrual basis, except as hereinafter indicated.

In its original return for the year 1924, filed prior to February 26, 1926, the petitioner changed its method of reporting income to the installment basis, and the respondent approved the change. The petitioner reported its income for 1925 and 1926 upon the installment basis.

The respondent recomputed the petitioner's income tax liability for the years 1918 to 1923, inclusive, and refunded to the petitioner the excess of the tax returned and paid for those years on the accrual basis, above the amount of the tax computed upon the installment basis for those years.

In its returns for 1924 and 1925 the petitioner excluded amounts received in each of those years on account of installment sales made prior to 1924. In determining the deficiencies, the respondent has included such payments in petitioner's income for these years. The amounts excluded by the petitioner and included by the respondent are as follows:

1924	$294,452.65
1925	29,009.86

In its return for 1926 the petitioner included in its income $6,864.68 as profits received in 1926 on account of installment sales made prior to 1924.

On November 18, 1926, the petitioner and Elliott-Fisher Co., a Delaware corporation, entered into an agreement which, in so far as material here, is as follows:

46 The [Elliott-Fisher] Company shall cause a new corporation to be organized having a presently issued capital stock consisting of

(a) 12,500 shares of $7.00 preferred stock of the par value of $100. each; [provision was made for the issuance of additional shares and for the retirement of this preferred stock at stated intervals] * * * The $7.00 preferred stock shall have no voting power unless dividends thereon at the rate herein provided shall be in default in the amount of at least $7.00 per share. * * *

(b) 30,000 shares of common stock without nominal or par value; * * * Each holder of common stock shall be entitled to one vote for each share of such stock held by him.

It is agreed notwithstanding the foregoing that the new corporation may issue such additional shares of $7.00 preferred stock as may be necessary or desirable in connection with the settlement hereunder of the Profit and Loss of the Sundstrand Corporation [petitioner] between September 30, 1926 and the closing date of the purchase herein contemplated * * *. The new corporation may also issue from time to time such additional shares of common stock as may be deemed necessary or desirable for any purpose.

The new corporation shall be incorporated under the Laws of such state and shall have such powers and charter provi-

sions and such by-laws as counsel for the company may deem necessary or advisable, not inconsistent, however, with the provisions contained herein with respect to the common and preferred stock of the new corporation.

Sundstrand Corporation [petitioner] will convey and transfer all of the Sundstrand Corporation's property including, without limitation by reason of the enumeration thereof, all of the property and assets of the Sundstrand Adding Machine Company of Illinois, the Sundstrand Canadian Adding Machine Company, Limited of Toronto, the Sundstrand Adding Machine Sales Company, Inc., and of all other subsidiary companies, if any, and the land and buildings to be acquired as hereinabove provided from Sundstrand Machine Tool Company to the new corporation or its nominee or nominees, free of any lien, incumbrance, indebtedness or charge thereon or with respect thereto, which could or might affect the title thereto; except, however, it shall not convey and transfer the sum of $100,000.00 in cash which is to be retained by the Sundstrand Corporation. * * *

Simultaneously with said transfer, the [Elliott-Fisher] Company will cause the new corporation to issue to or in accordance with the direction of Sundstrand Corporation [petitioner], 12,500 shares of the $7.00 preferred stock of the new corporation and to pay to said Sundstrand Corporation, $2,000,000.00 in cash; provided that the Company will also cause the new corporation, as soon as the facts with respect thereto can be ascertained and determined, to issue to or in accordance with the direction of the Sundstrand Corporation, such additional shares of the $7.000 preferred stock of the new corporation as shall equal at $100.00 per share, the amount of net profit, if any, of the Sundstrand Corporation, arising from its business from and after September 30, 1926, to the date of said transfer and provided also that if a loss shall result from the operation of the Sundstrand Corporation's business in the period from and after September 30, 1926, to the date of said transfer, said 12,500 shares of the $7.00 preferred stock of the new corporation shall be reduced on the basis of one share for each $100.00 of such loss. The net profit of the Sundstrand Corporation for the period from September 30th, 1926 to the date of said transfer as herein provided, shall be calculated in accordance with good accounting practice.

Simultaneously with, or at the Company's option before, said transfer of the Sundstrand Corporation's property to the

new corporation, the Company will cause the new corporation to issue to the Company, 30,000 shares of its common stock upon payment therefor by the Company of the sum of $2,000,000.00 in cash.

Sundstrand Corporation has submitted to the Company, a financial statement of its assets and liabilities as of September 30, 1926. Said financial statement indicates tangible assets in excess of $2,420,000; Liabilities of approximately $331,000 and Tangible Net Worth in excess of $2,090,000.00, It is represented that the estimated net profit for the year 1926, after all taxes, bonuses and other charges, will be approximately $400,000.00. * * *

Sundstrand Corporation represents that at the time of such transfer of the Sundstrand Corporation's property to the new corporation, the net worth of Sundstrand Corporation will be such that the financial status of the new corporation will then be as good or better than that shown by the tentative balance sheet hereto annexed and marked Exhibit A, less $100,000 in cash, plus any operating profits made by the Sundstrand Corporation, between September 30, 1926 and the date of such transfer.

* * * * * *

The new corporation may at its option use the name Sundstrand Corporation or Sundstrand as or as a part of its corporate name or that of any of its subsidiaries, and the Sundstrand Corporation will when and as requested by the new corporation or the Company make any necessary change in its corporate name or that of any of its subsidiaries or otherwise so that the new corporation and its subsidiaries may be in a position to register to do business in any state in the United States or elsewhere.

On November 18, 1926, at a special meeting of the petitioner's stockholders, called—

* * * for the purpose of considering and acting upon a proposition made to this Corporation to sell and dispose of all of its property and assets and for the transaction of any and all business pertaining to the consideration of and action upon said proposal or necessary in connection therewith,

the following resolutions were adopted:

Resolved that the Stockholders of the Company in meeting duly assembled hereby approve said Agreement, and authorize and direct the sale and transfer of all the property and assets of this Company upon the terms and conditions therein provided; and further

Resolved that the Board of Directors and Officers of this

company be and they hereby are authorized and directed to take such steps and to execute such instrument or instruments including said Agreement, with such modifications thereof or supplements thereto, as in their opinion may be necessary or desirable in order to effect such sale and transfer; and further

Resolved that upon the consummation of said reorganization and sale, the proceeds consisting of preferred capital stock and cash received from such sale be distributed immediately to the stockholders in the order of their preferential rights, the preferred stock being first fully redeemed and the balance distributed to the common stockholders; and further

47 Resolved, that this corporation, after the consummation of said re-organization and sale under the said agreement with Elliott-Fisher Company and the distribution of the proceeds in accordance with the reorganization plan to its stockholders in the manner provided above, shall cease operation, and the directors and officers thereof shall proceed to liquidate the corporation and cause the same to be dissolved.

The further unanimous action was taken, as recorded in the following minutes of that meeting:

Resolved that the name of this Corporation be and is hereby changed from Sundstrand Corporation to John A. Nelson Co.

Pursuant to the terms of the agreement with Elliott-Fisher Co., the petitioner's properties were transferred to a new corporation, organized under the laws of the State of Delaware, and the petitioner received therefor 14,060 shares of the preferred stock of the new corporation and $2,000,000 in cash. The petitioner immediately used part of the cash so received to retire its own preferred stock and distributed the 14,060 shares of the new company's preferred stock and the balance of the cash to its common stockholders.

As of December 31, 1926, the books of the petitioner showed a reserve for "Unrealized Profit" on installment sales in the amount of $322,980.29. The respondent added the $322,980.29 to petitioner's income in arriving at the deficiency here in question, on the ground that when it exchanged its assets for stock and cash the petitioner collected 100 per cent for the total outstanding installment accounts receivable. Included in the $322,980.29 is an amount of $1,640.49 representing uncollected profits on sales made prior to 1924. The $1,640.49

is not included in the $6,864.68 representing collections on prior installment sales, reported in 1926.

OPINION.

SMITH: The petitioner contests the respondent's disallowance of the deductions claimed by reason of the payment of 5 per cent of its net profits to the Sundstrands in each of the taxable years before us. The respondent has treated these amounts as capital expenditures, applying them to the several United States patents, and has allowed deductions for their amortization over the remaining term of the patents. The petitioner argues that the patents had been acquired prior to the payments now in question and that:

> * * * Instead * * * of giving the Sundstrands a bonus in some fixed and perhaps arbitrary amount, petitioner and the Sundstrands agreed to have the extra compensation measured by the direct index of the effect of the services of the Sundstrands—petitioner's profits. * * *

The Board has held that the cost of patents, legal expenses incidental to procuring and protecting the patents, and experimental expenses in connection with their development are capital expenditures. See *Beaumont Co.*, 3 B. T. A. 822; *American Seating Co.*, 4 B. T. A. 649; affd. on this point, 50 Fed. (2d) 681; *Buffalo Forge Co.*, 5 B. T. A. 947; *Grand Rapids Show Case Co.*, 12 B. T. A. 1024. See also *Dempster Mill Mfg. Co.* v. *Burnet*, 46 Fed. (2d) 604. However, we also held in *American Seating Co., supra*, that an item of $15,000 representing royalty payments was not to be treated as a capital expenditure.

The agreement with the Sundstrands recited that the petitioner had been granted nine domestic and eight foreign patents on inventions made by the Sundstrands, who had also assigned to the petitioner their entire rights to eighteen domestic and eight foreign applications for letters patent. Apparently, if the amounts in question are to be treated as capital expenditures, the capitalization must be with respect to both foreign and domestic patents and applications therefor.

While the Sundstrands owned shares of stock in the petitioner, no point is made that the payments bore any relation to their stockholdings. Their services were doubtless of value to the petitioner and, in recognition of the Sundstrands' contributions to the success of the enterprise, the petitioner agreed to pay them a percentage of its annual net profits.

Whether we consider the payments based upon a percentage of profits as compensation for services rendered (see *Tyler & Hippach, Inc.*, 6 B. T. A. 636, 641), or as in the nature of a rental or royalty for the use of the product of their inventive genius (see *Webb Press Co., Ltd.*, 3 B. T. A. 247; Office Decision 440, Cumulative Bulletin No. 2, p. 215), such payments were in satisfaction of an obligation relating directly to the business of the particular year for which they were paid. We can not see that these payments add anything to the petitioner's capital investment, it having already acquired the patents and applications therefor. There are further practical difficulties in treating these payments, relating to the business of a particular year and measured by the success of that year's operations, as capital expenditures. These difficulties are the changing base upon which to rest an amortization allowance, the variable terms of the several patents, and the term of the agreement as opposed to the term of the patents, requiring the payments to the Sundstrands even in the last year of the term of a patent or patents, but not requiring payments in a year when there were no profits, even though the cost of the patents would nevertheless be subject to amortization. In these circumstances, we hold that the respondent erred in capitalizing the expenditures involved and that the deductions claimed should be allowed. Cf. *Jamieson Coal & Coke Co.*, 24 B. T. A. 554; *Hutchison Coal Co.*, 24 B. T.
48 A. 973; affd., ... Fed. (2d) ..... (C. C. A., 4th Cir., Apr. 3, 1933); *L. Schepp Co.*, 25 B. T. A. 419, 430; *In re General Film Corp.*, 274 Fed. 903.

The second issue is whether the amounts collected in the respective taxable years upon installment sales made prior to 1924 are to be included in the income of the year of collection. The petitioner relies upon the provisions of section 705 (a) (2) of the Revenue Act of 1928, which is as follows:

> (a) If any taxpayer by an original return made prior to February 26, 1926, changed the method of reporting his net income for the taxable year 1924 or any prior taxable year to the installment basis, then, if his income for such year is properly to be computed on the installment basis—
>
> * * * * * *
>
> (2) No deficiency shall be determined or found in respect of any such taxes unless the taxpayer has underpaid his taxes for such year, computed by excluding, in computing income, amounts received during such year on account of sales or other dispositions of property made

in any year prior to the year in respect of which the change was made.

The facts are not in dispute, and, viewing the matter purely from the standpoint of the original installment sales returns for 1924 and subsequent years, the petitioner is within the letter of the statute. But, "A thing may be within the letter of a statute and not within its meaning, and within its meaning, though not within its letter. The intention of the lawmaker is the law." *Smythe* v. *Fiske,* 23 Wall. 374, 380. We have held that where a taxpayer, by an original return filed within the time prescribed by statute, changes from the accrual to the installment basis of reporting its income, "no deficiency shall be determined on account of amounts received during the taxable year from sales made in years prior to that of the change to the installment basis." *Tull & Gibbs, Inc.,* 21 B. T. A. 1073, 1074. See also *S. Davidson & Bros., Inc.,* 21 B. T. A. 638; *Grand Rapids Show Case Co., supra.*

In *Jacob Bros. Co.* v. *Commsisioner,* 50 Fed. (2d) 394, 396, the Circuit Court of Appeals for the Second Circuit determined that uncollected profits upon installment sales which had been reported upon the accrual basis should be included in invested capital of the years following a change to the installment basis of reporting income. The court said, *inter alia:*

> * * * Section 705 permits the taxpayer to exclude from the later year's income cash collected on installment contracts reported on the accrual basis in years prior to the change of method. In other words, *the accrual method was allowed to stand unaffected in respect to income for years prior to* 1918. Hence the surplus and undistributed profits account obtained by the accrual method is likewise unaffected by the change. * * * (Italics supplied.)

Under section 212 (d) of the Revenue Act of 1926, the Commissioner was given authority to prescribe regulations for reporting income upon the installment basis. Article 42, Regulations 69, provides such regulations for reporting income from the sale of personal property on the installment plan, and further that:

> The provisions of this article shall be retroactively applied in computing income from the sale of personal property under the Revenue Acts of 1916, 1917, 1918, 1921, and 1924, or any such Acts as amended. (See sec-

tion 1208). Any dealer in personal property on the installment plan whose books of account contain adequate information and were kept so that income can be accurately computed on the installment basis in accordance with the provisions of this article may file amended returns accordingly, and the excess of the amount of any tax previously paid over the tax as computed on the installment basis as herein provided shall, subject to the statutory period of limitations properly applicable thereto, be credited or refunded as provided in section 284 and articles 1301-1306.

The facts show that the respondent recomputed the petitioner's tax liability for the years 1918 to 1923, inclusive, and refunded to the petitioner the excess of the tax paid for those years on the accrual basis above the amount of the tax computed upon the installment basis. The petitioner, having received the benefit of such readjustments to its income, insists that it should receive afurther benefit by excluding the amount of the collections in 1924, 1925, and 1926 upon installment sales prior to 1924 from its income for those years. We do not believe such dual benefits were intended by Congress. The accrual method used by this taxpayer was not allowed to stand and is affected by the adjustments made by the respondent, and the refunds accepted by the petitioner in accordance with article 42 of Regulations 69. "Men must turn square corners when they deal with the Government." *Rock Island, A. & L. R. Co.* v. *United States,* 254 U. S. 141. This petitioner, having received the benefit of the change to the installment basis of reporting income, not only for the years following the change but also for the years prior to that change, should not be heard to complain because the respondent has included in its income for 1924, 1925, and 1926, amounts representing collections upon installment sales of prior years, which otherwise would go untaxed. Otherwise, this petitioner's true income would not be properly returned for taxation. In these circumstances, the respondent is sustained.

The remaining issue is whether the respondent has erroneously included in income for 1926 an amount of $322,980.29, representing "the reserve for unrealized profit on installment sales." It appears that the petitioner disposed of the installment sales contracts to which this amount relates in 1926, and the respondent has treated the disposition as a realization of the profit. The petitioner contends that the disposi-

tion was a part of the transaction resulting in a reor-
49 ganization to which it was a party, and therefore no gain is to be recognized thereon.

These proceedings were submitted upon a stipulation, in which appears the following statement: "On December 31, 1926, petitioner was a party to a reorganization." In *Jamison Coal & Coke Co., supra,* we said:

> • • • Stipulations can relate only to facts. We can not recognize or give effect to stipulations of law. • • •

On brief—

> The respondent contend(s) that the $322,980.29 represented profits which the petitioner made *at the time the merchandise was sold.* By virtue of Sections 212 (d) and 1208 of the Revenue Act of 1928, petitioner, because it had sold on the installment plan, was given a special privilege. That privilege was the right to defer payment of taxes on the profits on installment sales until the collection of the installment payments. • • •
>
> When the petitioner disposed of those accounts receivable it, by its own voluntary act, terminated its right to the privilege of deferment, and since it received dollar for dollar in stock and cash for those accounts receivable, the portion of such accounts representing income became realized profit to the petitioner—not a profit resulting from or coming into existence on account of the reorganization (*sic*), but merely the collection of a profit earned prior to that time. • • •

In *Packard Cleveland Motor Co.,* 14 B. T. A. 118, the Board held that the taxpayer realized income upon the sale of installment obligations in the taxable year. The provisions of section 44 (d) of the Revenue Act of 1928 lend color to the respondent's contention, but that section of the statute is not retroactive in its effect. In *Wallace Huntington,* 15 B. T. A. 851, we held that the taxpayer realized no income from the gift of installment obligations. In *Virginia Beach Golf Course Annex Corp.,* 23 B. T. A. 1170, we held that the taxpayer realized no income from the distribution of installment obligations to its stockholders.

Charles F. Meagher, 20 B. T. A. 68, involved a disposition of installment obligations in an exchange of property for stock. The syllabus of that case follows:

> Gain or Loss—Exchange—Installment Obligations.—Petitioner, doing business as a sole proprietor, to a large

extent on the installment basis, organized a corporation to which he transferred in 1923 all of the assets of the business for all of its authorized capital stock. Included in the assets conveyed were $117,863.13 of uncollected installment obligations representing unrealized profits of $53,488.57. *Held* that the transfer of these installment obligations, being a transaction provided by section 202 (c) (3) of the Revenue Act of 1921 not giving rise to gain or loss, respondent erred in including in petitioner's income for the year 1923 the sum of $53,488.57 as a profit realized by reason of petitioner's disposition of them in this manner.

The facts of the *Meagher* case clearly established a nontaxable exchange within the purview of section 202 (c) (3) of the Revenue Act of 1921. In disposing of the respondent's contention that "the amount represented by the profit included in the installment obligations would escape tax", we said:

> * * * that result does not necessarily follow, as this petitioner has received in the transaction stock of the corporation in exchange for the assets conveyed, and the realization as income of the value represented by the profit included in the amount of the installment obligations in question, is merely deferred until the sale by him of the stock received upon such sale, as his gain would be measured upon the basis of the cost to him of the transferred assets, which would not include the $53,488.57 of profit included in the $117,863.13 of installment obligations.

In the instant proceedings this corporate taxpayer transferred all of its assets, including the installment obligations, except $100,000 in cash, to the new corporation in exchange for $2,000,000 in cash and 14,060 shares of the new company's preferred stock of the par value of $100 per share. The Elliott-Fisher Co. paid into the new corporation the $2,000,000 of cash and received all of the new corporation's voting stock. The petitioner used a portion of the cash to retire its own preferred stock and distributed the balance of the cash and the 14,060 shares of preferred stock to its common stockholders. It does not appear that the petitioner corporation has ever been dissolved.

The petitioner contends that there was a reorganization to which it was a party and that no gain or loss is to be recognized upon the transfer of its property to the new corporation. Unlike the transfer in the *Meagher* case, this petitioner

neither transferred all of its property nor received all of the stock of the transferee. The pertinent portions of the Revenue Act of 1926 are set out in the margin.[1]

50 The petitioner was not a party to a reorganization within the meaning of the statute. Upon the transfer, pursuant to the terms of the confract of sale, the petitioner neither transferred all of its property nor received "a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock" of the new corporation. Nor does it appear that this petitioner was ever in control of the new corporation, or that the new corporation was in control of the petitioner. Furthermore, while the transferee may be said to have acquired substantially all the properties of this petitioner, disregard-

[1] SEC. 203. (a) Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 202, shall be recognized, except as hereinafter provided in this section.

* * * * * * *

(b) (3) No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

* * * * * * *

(c) If an exchange would be within the provisions of paragraph (3) of subdivision (b) if it were not for the fact that the property received in exchange consists not only of stock or securities permitted by such paragraph to be received without the recognition of gain, but also of other property or mney, then—

(1) If the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchahge, but

(2) If the corporation receiving such other prop[illegible] money does not distribute it in pursuance of the plan of reorganizatio[illegible] gain, if any, to

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the corporation shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property so received, which is not so distributed.

* * * * * * *

(h) As used in this section and sections 201 and 204—

(1) The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization or (D) a mere change in identity, form, or place of organization, however effected.

(2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation.

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ing, for the moment, the petitioner's retention of $100,000 in cash, and thereby became the "corporation resulting from a reorganization", and as such is "a party to a reorganization", that does not make this petitioner "a party to a reorganization" since that term includes both corporations (transferee and transferor) only in the event that one acquires at least a majority of the voting and other stock of the other. Here, the petitioner acquired only nonvoting stock in the new corporation, and that corporation acquired none of the petitioner's stock. The petitioner has not brought the transactions within the provisions of section 203 (h). As the Supreme Court said in *Pinellas Ice & Cold Storage Co.* v. *Commissioner*, 287 U. S. 462, "Certainly, we think that to be within the exemption the seller must acquire an interest in the affairs of the purchasing company more definite than that incident to ownership of its short term purchase money notes." Little more than that was acquired by this petitioner, since definite provision was made in the agreement with Elliott-Fisher Co. for the retirement of the nonvoting preferred stock issued to the petitioner. See also *Cortland Specialty Co.* v. *Commissioner*, 60 Fed. (2d) 937.

The exemption provided in section 203 (b) (3) relates to exchanges of property by "a corporation a party to a reorganization", and is enlarged by section 203 (e) on condition that the transferee distribute the money and property received upon the exchange "in pursuance of the plan of reorganization." There is nothing in the agreement with Elliott-Fisher Co. directing the distributions that the petitioner made to its stockholders. That agreement apparently contemplated the continuance of the petitioner's corporate existence, for provision was made, and later acted upon, whereby the corporate identity of the petitioner was changed from Sundstrand Corporation to John A. Nelson Co. Furthermore, the petitioner's stockholders authorized "the sale and transfer" of its property and assets, and the distribution of the consideration "received from such sale." In these circumstances, the transaction involved can not be said to have been a nontaxable exchange of property. Cf. *Howard F. Burns, Executor*, 28 B. T. A. No. 6 (May 5, 1933); *Connecticut Power Co.*, 28 B. T. A. No. 7 (May 5, 1933).

The fact that the petitioner disposed of its installment obligations in a taxable transaction distinguishes this case from the *Meagher* case, *supra*, and we accordingly hold that the respondent properly determined that the petitioner realized

the deferred profit upon installment obligations when it disposed of the obligations in 1926, there being nothing in the record to indicate that the petitioner did not receive the full face value of such obligations.

Reviewed by the Board.

JUDGMENT WILL BE ENTERED UNDER RULE 50.

TRAMMELL, MURDOCK, GOODRICH, LEECH and ADAMS concur in the result.

VAN FOSSAN dissents.

51 • • (Caption 32986 and 44700) • • Entered Sep. 7 1933.

DECISION.

Pursuant to the findings of fact and opinion of the Board in the above-entitled proceedings promulgated June 23, 1933, the respondent on August 16, 1933, filed a notice of settlement. Hearing was had thereon on September 6, 1933, at which time counsel for the petitioner filed an acquiescence to the computation filed by the respondent. Wherefore, it is

Ordered and Decided that the liability of the petitioner to income tax is as follows:

Year	Income Tax Liability	Income Tax Assessed	Deficiency in Payment	Overassessment to be Abated
1924	$33,612.54	$33,612.54	None	None
1925	54,634.75	54,634.75	None	None
1926	97,174.22	99,426.91	$43,602.34	$2,252.69

(Signed) CHARLES P. SMITH,
Member.

Entered Sep. 7, 1933.

Enter:

CPS:aa.

52 • • (Caption) • • Filed Nov. 28 1933.

PETITION FOR THE REVIEW OF DECISION OF THE UNITED STATES BOARD OF TAX APPEALS.

Filed Nov. 28, 1933.

To the Honorable Judge of the United States Circuit Court of Appeals for the Seventh Circuits:

John A. Nelson Company, in support of this petition, filed

in pursuance of Section 1001 of the Act of Congress approved February 26, 1926, entitled The Revenue Act of 1926, for the review of the decision of the United States Board of Tax Appeals rendered on September 7, 1933, determining a deficiency in payment of income tax of this Petitioner for the calendar year 1926 of $43,602.34, respectfully shows to this Honorable Court as follows:

I.

Statement of the Nature of the Controversy.

1. On May 23, 1929, the Petitioner filed with the United States Board of Tax Appeals (hereafter referred to as
53 the Board) in accordance with the provisions of the Revenue Act of 1926, its petition for the redetermination of the deficiency in income tax for the calendar year 1926, in the sum of $45,855.02 as proposed by the respondent and set forth in the final notice of deficiency mailed to the petitioner by the respondent on March 25, 1929. Said petition, insofar as is here material, alleged in part as follows, namely that:

The petitioner is an Illinois corporation with principal office at Rockford, Illinois and was formerly engaged in the manufacture and sale of milling and adding machines. The taxes in controversy are income taxes for the calendar year 1926.

Prior to 1926, the petitioner reported income from instalment sales on the instalment basis. The reserve for unrealized profit on said instalment sales on December 31, 1926 was $322,980.29. At December 31, 1926, petitioner in a reorganization transferred substantially all of its assets to the Sunstrand Corporation of Delaware, in exchange for cash and preferred stock of that company. The respondent erroneously added said reserve of $322,980.29 to petitioner's income for the year 1926 and computed the deficiency accordingly.

2. Thereafter, on July 24, 1929, the respondent filed with the Board, his answer to said petition which answer admitted that petitioner is an Illinois corporation, formely engaged in the manufacture and sale of milling and adding machines. It admitted that the deficiency notice was mailed to the petitioner on March 25, 1929 and that the taxes in controversy
54 are for the calendar year 1926; but denied the remaining allegations of fact in the petition.

Thereafter, the petitioner filed amendments, not here ma-

terial, to the petition on November 15, 1930. Permission therefor was granted by the Board on March 4, 1931, and answer thereto filed by the respondent on March 11, 1931.

3. The cause being at issue under the Rules of Practice of the Board, it duly came on for hearing on June 26, 1930, whereupon the petitioner and respondent submitted a stipulation of facts and agreed that the Board determine the appeal from said stipulated facts. The pertinent facts contained in the stipulation, as later corrected by motion dated November 14, 1930, of petitioner and consented to by the respondent, are as follows:

The petitioner is an Illinois corporation, witth its principal office at Rockford, Illinois. It is now inactive, but during the years 1924 to 1926, inclusive, it was engaged in the manufacture and sale of milling and adding machines under the name of Rockford Milling Machine Company. In June 1926, the name of the corporation was changed from Rockford Milling Machine Company to Sunstrand Corporation. In December 1926, its name was changed to John A. Nelson Company.

On December 31, 1926, petitioner was a party to a reorganization, pursuant to the plan of which it transferred substantially all of its properties to the Sunstrand Corporation of Delaware in exchange for 14,060 shares of the pre-
55 ferred stock of the Delaware Corporation, and $2,000,000 cash. The petitioner immediately used part of the cash so received to retire its own preferred stock and immediately distributed the preferred stock and the balance of the cash so received to its own stockholders, pursuant to the reorganization plan. The contract between petitioner and Elliott-Fisher Company, and the minutes of the meeting of petitioner's stockholders in respect of these transactions were attached to the stipulation.

No gain or loss was recognized or reported by the petitioner in its 1926 return with respect to the said transfer of its properties to the Sunstrand Corporation of Delaware. This treatment was approved by the respondent except as to the reserve for unrealized profit on instalment sales which amounted to $322,980.29 as of December 31, 1926. The respondent added to petitioner's income, in arriving at the deficiency here in question, the $322,980.29, on the ground that the petitioner collected, when it exchanged its assets for stock and cash, 100% for the total outstanding instalment accounts receivable.

4. Thereafter, on November 30, 1931, the Board promulgated its findings of fact in accordance with said stipulation. Along with its findings of fact, the Board rendered an opinion, 24 B. T. A. 1031, in which it "Held, under the circumstances here, that 'unrealized profits' on installment sales are not taxable where in 1926 petitioner, as a party to a reorganization, transferred substantially all its assets for stock of the second party in the reorganization and $2,000,000 in cash, and such stock and cash were immediately dis-
56 posed of by petitioner in accordance with the plan of reorganization".

On December 19, 1931, the Chairman of the Board directed, pursuant to section 601 (b) of The Revenue Act of 1928, that said division report in the above entitled proceeding, be reviewed by the Board.

On April 13, 1932, the Board issued an order in which it, of its own motion, set aside the prior submission of the case, and called for proof of the stipulated fact that "On December 31, 1926, petitioner was a party to a reorganization".

On August 10, 1932, petitioner filed a motion to vacate the Board's order of April 13, 1932.

The proceedings came on for hearing on September 14, 1932, at which time, said motion was also heard. Petitioner challenged the right of the Board to conduct further hearings under the circumstances, and offered no further evidence; neither did respondent.

On May 31, 1933, the Board issued a memorandum sur order and an order denying petitioner's motion of August 10, 1932, to vacate its order of April 13, 1932.

On June 23, 1933, the Board promulgated its findings of fact and rendered its opinion, 28 B. T. A. No. 94, five members separately concurring and one dissenting in the result. Said findings and opinion, contrary to and inconsistent with the stipulation of facts filed with the Board on June 26, 1930, held that petitioner was not a party to a reorganization in
57 connection with the transfer of its assets to Sunstrand Corporation of Delaware; it further held, contrary to and inconsistent with the stipulation and to the respondent's own action in the matter, that the transaction involved was a taxable exchange of property. The Board thereupon held that petitioner realized a taxable profit of said $322,980.29; and the Board entered decision accordingly, in favor of the respondent.

5. On September 7, 1933, the Board entered its final order of redetermination fixing a deficiency of $43,602.34 for the year 1926.

II.

Designation of Court of Review.

The petitioner, being aggrieved by the said opinion, decision and order of the Board, and being a corporation with its principal place of business in the City of Rockford, State of Illinois, desires a review thereof in accordance with Section 1002 (b) of The Revenue Act of 1926 by the United States Circuit Court of Appeals for the Seventh Circuit, within which circuit is located the office of the Collector of Internal Revenue, Chicago, Illinois, to whom the said petitioner made its income tax return for the year in controversy.

III.

Assignments of Error.

Assignments of Error.

The Petitioner, as a basis of review, makes the following assignments of error:

58

1. The Board had no legal power to reopen the submission of the proceedings and bring the case up for rehearing.

2. The Board had no legal power to overturn the stipulated facts and make a finding opposed to the stipulated facts.

3. The Board erred as a matter of law in ignoring and subverting the stipulation of the parties; and in failing to find as facts, the facts stipulated by the parties on June 26, 1930; and in finding facts and rendering a decision inconsistent with and contrary to said stipulation and the evidence in the proceeding.

4. The Board erred in failing to find as a fact that on December 31, 1926, petitioner was a party to a reorganization pursuant to the plan of which it transferred substantially all of its properties to the Sunstrand Corporation of Delaware in exchange for 14,060 shares of the preferred stock of the Delaware corporation and $2,000,000 cash; and in failing to find that in further pursuance of the reorganization plan, the petitioner immediately distributed part of the cash so received to retire its own preferred stock and immediately

distributed the remainder of the cash and the preferred stock to its own stockholders.

5. The Board erred as a matter of law in holding that petitioner was not a party to a reorganization; in holding that the transaction here involved, was a taxable exchange of property; and in holding that the petitioner realized a profit from the transfer of its instalment accounts receivable in said transaction.

59 6. The Board erred in failing to hold that the petitioner was a party to a reorganization; in failing to hold that the transaction here involved was a non-taxable exchange of property in a reorganization; and in failing to hold that petitioner realized no taxable profit from the exchange of its instalment accounts receivable in such non-taxable reorganization.

7. The Board erred in setting aside the findings of fact and decision which its division promulgated on November 30, 1931.

8. The Board erred in ordering on April 13, 1932, that the prior submission of the case be set aside and that the case be reopened for further hearing.

9. The Board erred, in denying on May 31, 1933, petitioner's motion of August 10, 1932 in which petitioner moved that the Board vacate its order of April 13, 1932, setting aside the prior submission of the case and reopening it for further hearing.

10. The Board's findings of fact and decision are contrary to the weight of the evidence and contrary to law.

11. The Board erred in entering judgment against the petitioner and finding a deficiency in payment of tax for the year 1926 in the sum of $43,602.34, when in fact, there is no deficiency due.

IV.

Conclusion.

Wherefore, your petitioner prays that this Honorable Court may review said findings, decision, opinion, and orders
60 of the Board, and reverse and set aside the same to the extent of the assignments of error in the preceding paragraph, and that the Clerk of the Board be directed to transmit and deliver to the Clerk of this Court, certified copies of all and every of the documents necessary and material to the

presentation and consideration of the foregoing petition for review, and as required by the rules of this Court and statutes made and provided, to the end that the errors complained of may be reviewed and corrected.

J. S. SEIDMAN
Attorney for Petitioner
2 Lafayette Street
New York City

61 State of Illinois }
County of Winnebago } ss.

HUGO L. OLSON, being duly sworn, says that he is the Secretary and Treasurer of the John A. Nelson Company, the petitioner above named, and that as such, he has authority to and has signed the foregoing petition. That he has read the same and that the facts set forth therein are true to the best of his knowledge and belief and that said petition is filed in good faith.

HUGO L. OLSON

Sworn to and subscribed before me this 25th day of November, 1933.

ELSIE BROITZMAN
(Seal) *Notary Public.*

83 • • (Caption—44700) • • Filed Nov. 1933.

PRAECIPE FOR THE RECORD.

Filed Nov 28 1933

To the Clerk of the United States Board of Tax Appeals:

You will please prepare and, within sixty days of the date of filing of the Petition for Review, in the above stated case, transmit to the Clerk of the United States Circuit Court of Appeals for the Seventh Circuit, certified copies of the following documents:

1. The docket entries of proceedings before the United States Board of Tax Appeals in the case above entitled.
2. Pleadings before the Board.
3. Division findings of fact and opinion (Division report) 24 B. T. A. 1031.

4. Order of the Chairman of the Board, dated December 19, 1931 pursuant to Section 601(b) of The Revenue Act of 1928, directing that the Division Report be reviewed by the Board.

5. Order of the Board dated April 13, 1932, setting aside the prior submission of the proceeding and reopening the case for further hearing.

6. Petitioner's motion filed August 10, 1932, to vacate Board's order of April 13, 1932.

7. Order of the Board dated August 19, 1932, setting petitioner's motion of August 10, 1932 for hearing on September 14, 1932.

8. Order of the Board and memorandum sur order, both dated May 31, 1933, denying petitioner's motion of August 10, 1932.

9. Findings of fact and opinion (28 B. T. A. No. 94) and decision (September 7, 1933) of the Board.

10. Petition for Review.

11. Statement of the evidence settled or agreed upon.

12. This Praecipe for the Record.

The foregoing to be prepared, certified, and transmitted as required by law and the rules of the United States Circuit Court of Appeals for the Seventh Circuit.

Dated, New York, November 28, 1933.

J. S. SEIDMAN
Attorney for John A. Nelson Company
2 Lafayette Street
New York, N. Y.

84 * * (Caption—44700) * *

ORDER ENLARGING TIME.

For cause appearing of record, it is

Ordered: That the time for transmission and delivery of the record sur petition for review of the above entitled proceeding in the United States Circuit Court of Appeals for the Seventh Circuit, be and it is hereby extended to January 31, 1934.

(Signed) EUGENE BLACK
Member.

Dated: Washington, D. C.,
Jan. 23, 1934.
jd

Now, January 24, 1934, the foregoing order certified from the record as a true copy.

B. D. GAMBLE
(Seal) *Clerk, Board of Tax Appeals.*

85 * * (Caption—44700) * *

CERTIFICATE.

I, B. D. Gamble, clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to 90, inclsive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 24th day of Jan., 1934.

B. D. GAMBLE
(Seal) *Clerk, United States Board of Tax Appeals.*

[fol. 70] At a regular term of the United States Circuit Court of Appeals for the Seventh Circuit, begun and held in the United States Court room in the City of Chicago, in said Seventh Circuit on the third day of October, 1933, of the October Term in the year of our Lord One Thousand Nine Hundred and Thirty-Three and of our Independence the One Hundred and Fifty-Eighth.

5146

JOHN A. NELSON COMPANY

vs.

COMMISSIONER OF INTERNAL REVENUE

Petition for Review of Order of the United States Board of Tax Appeals

And on, to-wit: On the second day of February, 1934, there was filed in the office of the Clerk of this court an appearance of counsel for petitioner, which said appearance is in the words and figures following, to-wit:

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT, OCTOBER TERM, 1933

No. 5146

JOHN A. NELSON COMPANY

vs.

COMMISSIONER OF INTERNAL REVENUE

The Clerk will enter my appearance as counsel for the petitioner.

Jacob S. Seidman, 2 Lafayette Street, New York, N. Y.

Endorsed: Filed February 2, 1934. Frederick G. Campbell, Clerk.

[fol. 71] And afterwards, to-wit: On the eighth day of February, 1934, there was filed in the office of the Clerk of this court an appearance of counsel for respondent,

which said appearance is in the words and figures following, to-wit:

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT, OCTOBER TERM, 1933

No. 5146

JOHN A. NELSON COMPANY

vs.

COMMISSIONER OF INTERNAL REVENUE

The Clerk will enter our appearance as counsel for the respondent.

Sewall Key, Washington, D. C.

Endorsed: Filed. Frederick G. Campbell, Clerk, February 8, 1934.

And afterwards, to-wit: On the third day of March, 1934, there was filed in the office of the Clerk of this court an appearance of counsel for respondent, which said appearance is in the words and figures following, to-wit:

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT, OCTOBER TERM, 1933

No. 5146

JOHN A. NELSON COMPANY

vs.

COMMISSIONER OF INTERNAL REVENUE

The Clerk will enter our appearapces as counsel for the respondent.

E. Barrett Prettyman, General Counsel, Bureau of Internal Revenue. Brooks Fullerton, Special Attorney, Bureau of Internal Revenue.

Endorsed: Filed March 3, 1934. Frederick G. Campbell, Clerk.

[fol. 72] At a regular term of the United States Circuit Court of Appeals for the Seventh Circuit, begun and held in the United States Court room in the City of Chicago, in said Seventh Circuit on the second day of October, 1934, of the October Term in the year of our Lord One Thousand Nine Hundred and Thirty-Four and of our Independence the One Hundred and Fifty-Ninth.

And on the same day, to-wit: On the eighth day of February, 1934, there was filed in the office of the Clerk of this court a Stipulation, which said Stipulation is in the words and figures following, to-wit:

IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT, OCOBER TERM, —

No. 5146

JOHN A. NELSON COMPANY, Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

STIPULATION

It is hereby stipulated and agreed by and between counsel for petitioner and counsel for respondent, subject to the approval of the Court, that the above entitled case which is on the October 1, 1934 calendar for assignment for oral argument, be passed until after December 15, 1934.

Dated, September 26, 1934.

J. S. Seidman, Counsel for Petitioner. Frank J. Wideman, Counsel for Respondent.

Endorsed: Filed October 2, 1934. Frederick G. Campbell, Clerk.

[fol. 73] And on the same day, to-wit: On the second day of October, 1934, the following further proceedings were had and entered of record, to-wit:

Tuesday, October 2, 1934

Court opened by proclamation.

Before Hon. Samuel Alschuler, Circuit Judge, Hon. Evan A. Evans, Circuit Judge, Hon. William M. Sparks, Circuit Judge.

5146

JOHN A. NELSON COMPANY

vs.

COMMISSIONER OF INTERNAL REVENUE

Petition for Review of Order of the United States Board of Tax Appeals

It is ordered that this cause be, and the same is hereby continued.

And afterwards, to-wit: On the eighth day of January, 1935, the following further proceedings were had and entered of record, to-wit:

Tuesday, January 8, 1935

Court met pursuant to adjournment and was opened by proclamation.

Before Hon. Evan A. Evans, Circuit Judge, Hon. William M. Sparks, Circuit Judge, Hon. Louis FitzHenry, Circuit Judge.

5146

JOHN A. NELSON COMPANY

vs.

COMMISSIONER OF INTERNAL REVENUE

Petition for Review of Order of the United States Board of Tax Appeals

It is ordered by the court that this cause be, and the same is hereby set down for hearing on February 1, 1935.

[fol. 74] And afterwards, to-wit: On the first day of February, 1935, the following further proceedings were had and entered of record, to-wit:

Friday, February 1, 1935

Court met pursuant to adjournment and was opened by proclamation.

Before Hon. William M. Sparks, Circuit Judge, Hon. Louis FitzHenry, Circuit Judge, Hon. Walter C. Lindley, District Judge.

5146

JOHN A. NELSON COMPANY

vs.

COMMISSIONER OF INTERNAL REVENUE

Petition for Review of Order of the United States Board of Tax Appeals

Now this day come the parties by their counsel and this cause now comes on to be heard on the printed record and briefs of counsel and on oral arguments by Mr. J. S. Seidman, counsel for petitioner, and by Mr. Robert W. Anderson, counsel for respondent, and the court having heard the same takes this matter under advisement.

And afterwards, to-wit: On the twenty-third day of February, 1935, there was filed in the office of the Clerk of this court the opinion of the court, which said opinion is in the words and figures following, to-wit:

[fol. 75] IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT, OCTOBER TERM, 1934, JANUARY SESSION, 1935

No. 5146

JOHN A. NELSON COMPANY, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

PETITION FOR REVIEW OF DECISION OF THE UNITED STATES BOARD OF TAX APPEALS—February 23, 1935

Before Sparks and FitzHenry, Circuit Judges, and Lindley, District Judge

LINDLEY, District Judge:

The taxpayer petitions for a review of a decision of the Board of Tax Appeals, assessing additional taxes based

upon a holding that the transaction hereinafter discussed was not a reorganization within the meaning of the Revenue Act. Two questions are involved: first, whether a stipulation between the parties that on December 31, 1926, petitioner "was a party to a reorganization" is decisive of the question as to whether or not the transaction herein involved amounted to a reorganization within the meaning of Section 203 (h) of the Revenue Act of 1926; and, second, if such stipulation is not determinative, whether the transaction was a reorganization within the meaning of the statute.

In the stipulation of the parties before the Board, one recital was that on December 31, 1926, petitioner "was a party to a reorganization." If this stipulation is to be treated as an agreement "concerning the legal effect of ad- [fol. 76] mitted facts," it is obviously inoperative, "since the court cannot be controlled by agreement of counsel on a subsidiary question of law." Swift & Co. v. Hocking Valley Ry. Co., 243 U. S. 281, 289.

The actual question presented to the Board necessary to a final decision upon the merits was whether there was a reorganization. The stipulation was clearly an attempt to stipulate the existing facts to be within a certain legal definition. Whether there was a reorganization in view of all the facts presented was a question of construction of statutory law, and the agreement between counsel as to such construction was not binding upon the court and must be disregarded. It was either an agreement that entirely removed the question from the proceeding or it was an attempt to limit the function of the Board to decide the issues of liability. Consequently it is ineffective. To hold otherwise that a stipulation that facts which do not under the law constitute reorganization do effect a reorganization would necessitate that the court entertain a question which is not in actual controversy between the parties but one based upon the stipulation of the parties as to a fictional situation, thus presenting a moot case, Swift & Company v. Hocking Valley Ry. Co., 243 U. S. 281. See Smith v. Commissioner, 59 F. (2d) 533, holding that a stipulation that a certain transaction amounted to a gift did not exclude the Board or the Court from determining that question; United States v. Pugh, 99 U. S. 265, holding that the ultimate effect of the facts which the evidence establishes is in the nature of a question of law subject to review by

the Court. The question of what constitutes a reorganization is one that arises from a consideration of all the facts and is not determined by a mere label or rubber stamp which the parties themselves put upon as the transaction. Gregory v. Helvering, — U. S. — (January 7, 1935). The Board, therefore, had before it for determination the question as to whether or not a reorganization occurred.

The facts are undisputed and disclose that the transaction does not come within the intendment of the congressional definition of reorganization. On November 18, 1926, petitioner entered into a contract with Elliott-Fisher Company, a Delaware corporation, under the terms of which the latter agreed to organize a new corporation with a capital stock of 12,500 shares of (non-voting) preferred stock, and 30,000 shares of (voting) common stock and to [fol. 77] purchase all the common stock for $2,000,000 in cash. Thereafter the new corporation purchased from petioner substantially all of its property, with the exception of $100,000 in cash, paying therefor to petitioner $2,000,000 in cash and 12,500 shares of preferred stock in the new company. Out of the cash thus received petitioner called for redemption and retired its own preferred stock and distributed to its stockholders the preferred stock of the new company and the remainder of the cash received as purchase price. Petitioner was not dissolved. It retained its franchise and $100,000 in cash and acquired no interest in the corporation to whom it delivered its property, other than the preferred shares of stock, which it distributed to its stockholders. This preferred stock had no voice in the control of the new corporation, except in case of default in payment of dividends thereon. Petitioner remained liable for certain liabilities and for taxes.

When we analyze these facts it is apparent that the transaction essentially constituted a sale of the greater part of petitioner's assets for cash and the preferred stock in the new corporation, leaving the Elliott-Fisher Company in entire control of the new corporation by virtue of its ownership of the common stock.

The controlling facts leading to this conclusion are that petitioner continued its corporate existence and its franchise and retained a portion of its assets; that it acquired no controlling interest in the corporation to which it delivered the greater portion of its assets; that there was no continuity of interest from the old corporation to the new;

that the control of the property conveyed passed to a stranger, in the management of which petitioner retained no voice.

It follows that the transaction was not part of a strict merger or consolidation or part of something that partakes of the nature of a merger or consolidation and has a real semblance to a merger or consolidation involving a continuance of essentially the same interests through a new modified corporate structure. Mere acquisition by one corporation of a majority of the stock or all the assets of another corporation does not of itself constitute a reorganization, where such acquisition takes the form of a purchase and sale and does not result in or bear some material resemblance to a merger or consolidation. As was said in West Texas Refining & Development Co. v. Commissioner, 68 F. (2d) 77:

"The purpose of section 203, supra, was to relieve corporations from profits taxes in cases where there is only a [fol. 78] change in corporate form without an actual realization of any gain from an exchange of properties. It is intended to apply to cases where a corporation in form transfers its property, but in substance it or its stockholders retain the same or practically the same interest after the transfer. See Cortland Specialty Co. v. Commission (C. C. A. 2) 60 F. (2d) 937, 940; Pinellas Ice & Cold Storage Co. v. Commissioner, 287 U. S. 462, 53 S. Ct. 257, 77 L. Ed. 428; Id. (C. C. A. 5) 57 F. (2d) 188. Here it was contemplated that in substance the West Texas Company should dispose of its assets and receive therefor a cash consideration, and also stock. What was done amounted to a single transaction for income tax purposes, and when it was fully consummated the West Texas Company had received only a 50% stock interest in the Col-Tex Company and $184,771.34 in cash. Therefore the transaction was not within the exceptions defined in section 203 supra, and must be considered as a sale."

In the recent case of Gregory v. Helvering, supra, the Supreme Court has pointed out that it is essential, in order to carry into effect the intent of Congress in this respect, that an examination of the facts be had to determine whether there was indeed reorganization, even though the parties themselves may call a transaction a reorganization.

The court held that though it had no right to inquire into the motive of taxpayers in performing a legal act, it did have a right to say that the claim of reorganization was a mere legal fiction.

The decision of the Board of Tax Appeals is affirmed.

[fol. 79] And on the same day, to-wit: On the twenty-third day of February, 1935, the following further proceedings were had and entered of record, to-wit:

Saturday, February 23, 1935

Court met pursuant to adjournment and was opened by proclamation.

Before Hon. Evan A. Evans, Circuit Judge; Hon. Louis FitzHenry, Circuit Judge; Hon. Walter C. Lindley, District Judge.

5146

JOHN A. NELSON COMPANY

vs.

COMMISSIONER OF INTERNAL REVENUE

Petition for Review of Order of the United States Board of Tax Appeals

This cause came on to be heard on the transcript of record from the United States Board of Tax Appeals, and was argued by counsel.

On consideration whereof: It is now here ordered and adjudged by this court that the decision entered in this cause on September 7, 1933, by the United States Board of Tax Appeals be, and the same is hereby affirmed.

[fol. 80] UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

I, Frederick G. Campbell, Clerk of the United States Circuit Court of Appeals for the Seventh Circuit, do hereby certify that the foregoing typewritten and printed pages,

numbered from 1 to 10, inclusive, contain a true copy of the proceedings had and papers filed, excepting briefs of counsel, and stipulations and orders relating to the time for filing briefs in the case of John A. Nelson Company, Petitioner, vs. Commissioner of Internal Revenue, Respondent, No. 5146, October Term, 1934, as the same remains upon the files and records of the United States Circuit Court of Appeals for the Seventh Circuit.

In testimony whereof I hereunto subscribe my name and affix the seal of said United States Circuit Court of Appeals for the Seventh Circuit, at the City of Chicago, this 17th day of April A. D. 1935.

(Seal United States Circuit Court of Appeals, Seventh Circuit.)

Frederick G. Campbell, Clerk of the United States Circuit Court of Appeals for the Seventh Circuit.

[fol. 81] SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed October 14, 1935

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Seventh Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

FILE COPY

Office Supreme Court, U. S.
FILED
MAY 20 1935
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1934.

No. [redacted]6

JOHN A. NELSON COMPANY, *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

J. S. SEIDMAN,
80 Broad Street,
New York City,
Counsel for Petitioner.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1934.

JOHN A. NELSON COMPANY, *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR WRIT OF CERTIORARI.

Petitioner, John A. Nelson Company, by J. S. Seidman, its counsel, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Seventh Circuit entered in the above entitled case on February 23, 1935, affirming the decision of the Board of Tax Appeals in 28 B. T. A. 529.

Question Presented.

Where a taxpayer transfers substantially all of its assets to another corporation in exchange for all of the latter's preferred stock and a cash sum, and the taxpayer immediately distributes the preferred stock and cash so received to its own stockholders, and the taxpayer, though inactive, does not dissolve, does this constitute a reorganization within the meaning of Section 203(h) of the Revenue Act of 1926, the material portion of which for present purposes is as follows:

> "(1) The term 'reorganization' means (A) a merger or consolidation (including the acquisition by one corporation of * * * substantially all the properties of another corporation) * * *."

If, as petitioner contends, the answer is in the affirmative, no tax gain or loss results; if in the negative, tax gain or loss does enter. (See Appendix for more complete statement of applicable statutory provisions.)

Statement.

The issue here presented is not the creature of the parties, but of the Board of Tax Appeals (R. 39-40). *The parties stipulated that there was a reorganization* and their only contest was as to the tax effect of the reorganization (R. 13). A division of the Board promulgated an opinion (24 B. T. A. 1031) deciding the effect of the agreed reorganization (R. 26-39, especially 37-39). Thereafter, the Board, of its own motion, withdrew the opinion and ultimately promulgated another opinion (five members concurring in the result only, and one dissenting) declaring that there was no reorganization (R. 45-61, especially 58-60).

Petitioner was in the adding machine business (R. 12). On November 18, 1926, it entered into an agreement with Elliott-Fisher Company with respect to that business (R. 13). The agreement provided, among other things, for the organization by Elliott-Fisher Company of a new company with a capitalization of 12,500 shares of preferred stock and 30,000 shares of common stock (R. 14, 16). The terms of these stocks were set forth in detail (R. 14-16). Petitioner agreed to transfer all of its assets (except cash of $100,000, which constituted less than 3% of its assets), subject to all its liabilities, in exchange for the 12,500 shares of preferred stock and $2,000,000 in cash to be raised by the sale for that amount by the new company of 30,000 shares of common stock to Elliott-Fisher Company (R. 17, 18, 21-22). The new company was to have the right to use petitioner's name (then called the Sundstrand Corporation) and petitioner agreed, upon request, to change its own name for the purpose (R. 19). The date for the con-

summation of the transfer was fixed at December 31, 1926 (R. 20).

On November 18, 1926, a special meeting of petitioner's stockholders was held at which the foregoing agreement, described in the minutes as "providing for a reorganization" of the company and sale and transfer of its assets, was approved, and it was voted that upon the consummation of the transfer, the preferred stock and cash to be received from the new company be immediately distributed to petitioner's stockholders in the order of their preferential right (R. 23-24). It was also voted that "after the distribution of the proceeds in accordance with the reorganization plan", petitioner be dissolved (R. 24). It was voted, too, that in the meantime petitioner's name be changed to John A. Nelson Company so as to enable it to comply with the agreement (R. 24).

On December 31, 1926, the transfer and distribution were consummated, pursuant to the agreement of November 18, 1926 and the vote of petitioner's stockholders at the meeting of November 18, 1926 (R. 13).

Reasons for Granting the Writ.

1. Four decisions (including the one at bar) on the basic point have recently been handed down by the Circuit Courts of Appeals, and they are in sharp conflict with one another. Chronologically, the one at bar was first. The dissenting opinion of one of the others (holding for reorganization) and the prevailing opinion of a third (holding against reorganization) cite the instant case in support of the conclusions reached. In all likelihood, applications for writs will be applied for in all of these cases and will come up for consideration at the same time as this one.

Holding *for* reorganization:

C. C. A.—2: *John J. Watts* v. *Commissioner*, March 4, 1935, reversing 28 B. T. A. 1056; petition for rehearing denied March 27, 1935;

C. C. A.—8: *Minnesota Tea Company* v. *Commissioner,* March 25, 1935, reversing 28 B. T. A. 591 (dissent citing the present case).

Holding *against* reorganization:

C. C. A.—7: The present case, February 23, 1935, affirming 28 B. T. A. 529 and reversing 24 B. T. A. 1031;

C. C. A.—4: *The G. and K. Manufacturing Company* v. *Commissioner,* April 2, 1935, affirming unpublished B. T. A. opinion. (The present case cited in support of the Court's opinion.)

In each of these cases, the effect of absence of stock control over the transferee and of the continued existence of the transferor was the pivotal point. The Second and Eighth Circuits held these factors to be immaterial under the language of the statute, in determining whether a reorganization exists. The Fourth and Seventh Circuits held the other way.

2. Earlier decisions of the Circuit Courts likewise add to the conflict.

Holding *for* reorganization:

C. C. A.—6: *Harry C. Howard* v. *Commissioner,* 56 Fed. (2d) 781, affirming 20 B. T. A. 207. *Certiorari denied* 53 S. Ct. 19;

C. C. A.—4: *C. H. Mead Coal Co.* v. *Commissioner,* 72 Fed. (2d) 22, affirming on this issue 28 B. T. A. 599.

Holding *against* reorganization:

C. C. A.—10: *West Texas Refining and Development Company* v. *Commissioner,* 68 Fed. (2d) 77, affirming on this issue 25 B. T. A. 1254.

In these cases, the transferor had no stock control over the transferee, but did go out of existence. The Fourth and Sixth Circuits did not regard stock control as important. The Tenth Circuit held that the stockholders of the transferor must continue the same or practically the same percentage of stock interest in the transferee to constitute a reorganization.

3. The present decision is contrary to the principles laid down by the Supreme Court in *Pinellas Ice and Cold Storage Company* v. *Commissioner*, 287 U. S. 462. Reorganization was there said to exist if one corporation acquires substantially all of the assets of another, and the stockholders of the transferor have a continuing interest in the transferee.* Nothing at all was said about the necessity for control over the transferee or the dissolution of the transferor, or both. The imposition of these additional requirements by the Seventh and Fourth Circuits in effect confine reorganization to merger and consolidation in disregard of the statutory language in parentheses following the words "merger or consolidation", which is the very thing the Supreme Court decided against.

4. There is here involved an important question of income tax law, which now appears to be bathed in a hopeless sea of doubt. From 1921 until the Board's decision in *Minnesota Tea Company, supra*, in 1933, the regulations and rulings of the Treasury Department, and the decisions of the Board of Tax Appeals and the Courts, held *for* reorganization in the factual background presented by the instant case. These authorities were in turn basically

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* That preferred stock constitutes an interest in the corporation, see *Atlantic City Electric Co.* v. *Commissioner*, 288 U. S. 152, holding that "despite redeemability and the limitation of dividends, the owners of the preferred stock were not in the position of creditors, but were stockholders with a proprietary interest in the corporate undertaking * * *". Likewise, *Keen & Woolf Oil Company* v. *Commissioner*, 49 Fed. (2d) 45 (C. C. A. 5), where the Court declared that "'interest' refers to ownership, and may be retained either through preferred or common stock, and independently of voting power". To the same effect, see *I. Unterberg & Co.* v. *United States*, 64 Ct. Cls. 197.

grounded on the language and legislative history of the Acts. In reliance on these interpretations and the declared resulting absence of gain or loss, many corporations consummated transactions involving substantial amounts. The Board, beginning with the *Minnesota Tea Company* case, departed from these interpretations but with confusing inconsistency, even where, as in that case and in the present case, the Treasury Department agreed that there *was* a reorganization. This led to many and large additional assessments or assessment proposals, and to claims for refund (the latter, because of losses or increased depreciation deductions unallowable under the earlier interpretations).

As a result, there are many cases on the point now pending before the Board of Tax Appeals and the trial courts. In the Appellate Courts, *Helvering* v. *J. M. Harrison* is now before the Sixth Circuit on appeal from 30 B. T. A. 966, and in the Third Circuit, *Helvering* v. *Marjorie C. Langworthy* is pending on appeal from 30 B. T. A. 1217 (styled John S. Woodward before the Board). The reversal by the Eighth Circuit (and, in effect, the Second Circuit) of the Board's decision in *Minnesota Tea Company*, the case that started the discord, almost concurrent with decisions in the opposite direction by the Fourth and Seventh Circuits add to the troubled waters. It is altogether fitting, proper and necessary that the point involved be put finally at rest through the decision of the Supreme Court.

Wherefore, it is respectfully submitted that this petition should be granted.

J. S. SEIDMAN,
Counsel for Petitioner.

May, 1935.

APPENDIX—Applicable Statutes.

Section 203 of the Revenue Act of 1926:

"(b) (3) No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization."

"(e) If an exchange would be within the provisions of paragraph (3) of subdivision (b) if it were not for the fact that the property received in exchange consists not only of stock or securities permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then——

(1) If the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange * * *."

"(h) As used in this section and sections 201 and 204——

(1) The term 'reorganization' means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization or (D) a mere change in identity, form, or place of organization, however effected.

(2) The term 'a party to a reorganization' includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation."

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1935.

JOHN A. NELSON COMPANY, PETITIONER,

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE.

ON A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

BRIEF FOR PETITIONER.

J. S. SEIDMAN,
80 Broad Street,
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Counsel for Petitioner.

THE COURT PRESS, N. Y. C.

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JOHN A. NELSON COMPANY, PETITIONER.

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COMMISSIONER OF INTERNAL REVENUE.

BRIEF FOR PETITIONER.

OPINIONS BELOW.

The opinion of a division of the Board of Tax Appeals (R. 26-39) is reported in 24 B. T. A. 1031. This opinion was reviewed by the full Board (R. 39) and another opinion (R. 45-61) reported in 28 B. T. A. 529. The opinion of the Circuit Court of Appeals (R. 74-78) is reported in 75 Fed. (2d) 696.

JURISDICTION.

Judgment of the Circuit Court of Appeals was entered on February 23, 1935 (R. 78). The petition for certiorari was filed May 20, 1935, and granted October 14, 1935. The jurisdiction of this Court rests on Section 240(a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED.

Petitioner, a corporation, transferred substantially all of its assets to another corporation in ex-

change for all of the latter's preferred stock and a cash sum. Petitioner immediately distributed the preferred stock and cash so received to its own stockholders. Petitioner, though inactive, did not dissolve. The question is whether this constitutes a reorganization within the meaning of Section 203(h) of the Revenue Act of 1926, the portion of which here material, is as follows:

> "(1) The term 'reorganization' means (A) a merger or consolidation (including the acquisition by one corporation of * * * substantially all the properties of another corporation) * * *."

If, as petitioner contends, the answer is in the affirmative, no taxable gain or deductible loss results; if in the negative, as respondent contends, gain or loss does enter.

STATUTES INVOLVED.

The statutes involved are set forth in the Appendix, *infra*, pp. 23-25. Unless otherwise indicated, all section references in this brief will apply to the Revenue Act of 1926.

STATEMENT OF CASE.

The issue here presented is not the creature of the parties, but of the Board of Tax Appeals (R. 39-40). The parties stipulated that there was a reorganization and their only contest was as to the tax effect of the reorganization (R. 13). A division of the Board promulgated an opinion (24 B. T. A. 1031) deciding the effect of the agreed reorganization (R. 26-39, especially 37-39). Thereafter, the Board, on its own motion, withdrew the opinion and ultimately promulgated another opinion (five members concur-

ring in the result only, and one dissenting) declaring that there was no reorganization (R. 45-61, especially 58-60). The Circuit Court of Appeals affirmed the Board (R. 78).

Petitioner was in the adding machine business (R. 12). On November 18, 1926, it entered into an agreement with Elliott-Fisher Company with respect to that business (R. 13). The agreement provided, among other things, for the organization by Elliott-Fisher Company of a new company with a capitalization of 12,500 shares of preferred stock and 30,000 shares of common stock (R. 14, 16). The terms of these stocks were set forth in detail (R. 14-16). The preferred stock was to carry a 7% cumulative dividend and have no voting power except on certain dividend arrearages (R. 14-15). The new company was to have the right, on advance notice to stockholders, to retire the stock at designated prices on dividend dates (R. 14-15). Petitioner agreed to transfer all of its assets (except cash of $100,000, which constituted less than 3% of its assets), subject to all its liabilities (except for certain bonuses to employees, and for 1926 federal income taxes), in exchange for the 12,500 shares of preferred stock and $2,000,000 in cash to be raised by the sale for that amount by the new company of 30,000 shares of common stock to Elliott-Fisher Company (R. 17, 18, 21-22). The new company was to have the right to use petitioner's name (then called the Sundstrand Corporation) and petitioner agreed, upon request, to change its own name for the purpose (R. 19). The date for the consummation of the transfer was fixed at December 31, 1926 (R. 20).

On November 18, 1926, a special meeting of petitioner's stockholders was held at which the foregoing agreement, described in the minutes as "providing

for a reorganization" of the company and sale and transfer of its assets, was approved; and it was voted that upon the consummation of the transfer, the preferred stock and cash to be received from the new company be immediately distributed to petitioner's stockholders in the order of their preferential right (R. 23-24). It was also voted that "after the distribution of the proceeds in accordance with the reorganization plan", petitioner be dissolved (R. 24). It was voted, too, that in the meantime petitioner's name be changed to John A. Nelson Company so as to enable it to comply with the agreement (R. 24).

On December 31, 1926, the transfer and distribution were consummated, pursuant to the agreement of November 18, 1926 and the vote of petitioner's stockholders at the meeting of November 18, 1926 (R. 13).

SPECIFICATION OF ERRORS TO BE URGED.

The Circuit Court of Appeals erred:

1. In failing to hold that the exchange of substantially all the assets of a corporation for all the preferred stock of the acquiring corporation and a cash sum, followed by the distribution of the preferred stock and cash by the first company to its stockholders, is a reorganization within the definition of that term as set forth in Section 203(h) (1) of the Revenue Act of 1926.

2. In holding that said transaction constitutes a sale and not a reorganization.

3. In holding that the dissolution of the corporation transferring the assets, and/or the acquisition by the transferring corporation of a controlling interest in the affairs of the transferee is a prerequisite to the existence of a reorganization.

4. In affirming the decision of the Board of Tax Appeals.

SUMMARY OF ARGUMENT.

The statute says, in so many words, that a reorganization takes place through a merger or consolidation, including the acquisition by one corporation of substantially all the assets of another. This does not mean that the mere acquisition of a corporation's assets, without more, is a reorganization; but it does mean that such an acquisition, coupled with a continuing interest in the affairs of the transferee by the transferor, constitutes a reorganization. *Pinellas Ice and Cold Storage Company* v. *Commissioner*, 287 U. S. 462.

The required continuing interest is best reflected by stock. *Keen & Woolf Oil Company* v. *Commissioner*, 49 Fed. (2d) 45 (C. C. A. 5). Preferred stock is a proprietary interest in the affairs of a corporation. Limitation as to dividends, lack of voting power, redeemability, in no way impair the status of preferred stock as a proprietary interest in the affairs of a corporation. *Atlantic City Electric Co.* v. *Commissioner*, 288 U. S. 152. Therefore, the transfer of substantially all of a corporation's assets in exchange for all of the preferred stock of the transferee corporation—which was the transaction in the case at bar—constitutes a reorganization. (Cash was also involved, but by virtue of Section 203(e), it has no bearing on the basic question.)

The lower court went on the view that to spell reorganization, it must also appear, in addition to the foregoing, that the transferor acquires or remains in control of the affairs of the transferee, and/or that

the transferor dissolves. *West Texas Refining and Development Company* v. *Commissioner*, 68 Fed. (2d) 77 (C. C. A. 10); also, *The G. and K. Manufacturing Company* v. *Commissioner*, 76 Fed. (2d) 454 (C. C. A. 4), certiorari granted October 14, 1935. (The opinion in the latter case questioned whether substantially all of the assets were transferred and the decision seems to rest on that phase.) Not only is there no statutory sanction for such superimposed requisites, but the legislative history of the various revenue acts since 1918 also establishes that Congress did not intend that there should be such requisites. Furthermore, the years of administrative construction under the various acts, followed by re-enactment of the statute without change in respects here material, make clear that the Department charged with the execution of the statute never construed a reorganization to entail such requisites, and that Congress repeatedly stamped such construction with approval. *Minnesota Tea Company* v. *Commissioner*, 76 Fed. (2d) 797 (C. C. A. 8); *John J. Watts* v. *Commissioner*, 75 Fed. (2d) 981 (C. C. A. 2); *Zellerbach Paper Co.* v. *Helvering*, 293 U. S. 172, 178.

ARGUMENT.

A synoptic preliminary statement may be of help in positing the issue in its precise setting. Section 203(a) of the Revenue Act of 1926 brings the gain or loss on every sale or exchange of property into the tax calculation unless embraced by certain specific exceptions. One of the exceptions so specified has to do with certain types of reorganization, and the question presented to this Court for determination is whether the exception rather than the general rule applies to the environal facts here involved.

Assuming the exception does apply—and here is

the phase that is noteworthy *in limine*—there is no *exemption* from income tax; there is merely *deferment*. The *status quo* continues, pending a sale or exchange to which the general rule rather than the exception applies. Furthermore, even the deferment cuts two ways. It not only postpones gain, but also denies loss. The rule of strict construction applicable to exceptions and exemptions does not, therefore, invade this field. Any contraction of the scope of the exception here under consideration would, to be sure, narrow the band of transactions where gain can be deferred, but by the same token, it would widen the field of losses that could be immediately deducted. Under such circumstances, the interpretative approach should be neither with strictness nor bounty, but rather precision.

There is another phase that may, perhaps, best be disposed of in this prelude. The generic principle of non-recognition of gain or loss in a reorganization applies where the consideration taken back is stock or securities (Section 203(b) (2) (3)). However, under Section 203(e), cash or other property may accompany the stock or securities and still hold inviolable the non-recognition rule, if the cash or other property is distributed by the receiving corporation pursuant to the reorganization plan. In the case at bar, the consideration received by petitioner was preferred stock and cash, but as immediate distribution of the cash (and the preferred stock) was planned and consummated, the fact that cash was in part involved is rendered inconsequential and forms no part of the *desiderata*.

We are now, perhaps, somewhat better equipped to consider the question at issue in this case in the form to which it thus reduces itself, namely, whether an exchange by a corporation of substantially all of

its assets for all of the preferred stock of the acquiring corporation, constitutes a reorganization resulting in no taxable gain or deductible loss.

I.

The exchange of substantially all of the assets of a corporation for a stock interest in the transferee corporation squarely meets the statutory requirements for reorganization under Section 203(h) (1) (A).

In determining whether a transaction constitutes a reorganization in contemplation of the Revenue Act of 1926, we are not left to dabble with imponderables or generalities. The statute describes by metes and bounds, the niche into which the transaction must fit, to yield an affirmative answer. The part that counts is Section 203(h):

> "(1) The term 'reorganization' means (A) a merger or consolidation (including the acquisition by one corporation of * * * substantially all the properties of another corporation) * * *."

At first blush, it would appear that through the parenthetical material, the statute covers the case at bar *"ipsissimis verbis"*. However, the relationship of the parenthetically enclosed words to those of "merger or consolidation" immediately preceding, became a matter for judicial inquiry. The Board of Tax Appeals and some of the courts veered towards a narrow construction, which in effect blighted the scope of the parenthetical clause almost to extinction, and made as the *sina qua non,* a technical merger or consolidation. On the other hand, it was the view of other judicial bodies that the part in parentheses may

be considered wholly apart from and without reference to the words preceding and outside the parentheses.

It was inevitable that this Court be called upon to calm the turbulent waters, and it did so in *Pinellas Ice & Cold Storage Co.* v. *Commissioner*, 287 U. S. 462, as follows:

> "The words within the parenthesis may not be disregarded. They expand the meaning of 'merger' or 'consolidation' so as to include some things which partake of the nature of a merger or consolidation but are beyond the ordinary and commonly accepted meaning of those words—so as to embrace circumstances difficult to delimit but which in strictness cannot be designated as either merger or consolidation."

In other words, the court declared that while the predicate of the statutory definition of a reorganization in part (A) was that of merger and consolidation, the words in parentheses were added by Congress to get away from the narrow, limited, and technical meaning of "merger" and "consolidation". Affirmatively what was done through the parenthetical material was to expand and enlarge on the accepted meaning of the basic words.

The precise scope of the enlargement was likewise pointed out by the Court. Before quoting it, a word about the facts in the *Pinellas* case will supply a needed background. What was involved there, was a sale of assets for cash and a promissory note payable in three to four months. That of course, had not even the faintest semblance or slightest practical assimilation to a merger or consolidation, no matter

how expansive a view of those words is applied. Nevertheless, the taxpayer contended that the sale was a reorganization. The Court replied:

> "But the mere purchase for money of the assets of one company by another, is beyond the evident purpose of the provision, and has no real semblance to a merger or consolidation. Certainly, we think that to be within the exemption the seller must acquire *an interest* in the affairs of the purchasing company more definite than that incident to ownership of its short term purchase money notes. This general view is adopted and well sustained in *Cortland Specialty Co.* v. *Commissioner of Internal Revenue*, 60 F. (2d) 937, 939, 940. It harmonizes with the underlying purpose of the provisions in respect of exemptions and gives some effect to all the words employed."

In the *Cortland Specialty Co.* case cited with approval in the foregoing quotation, the taxpayer made the same contention as before the Supreme Court. The Second Circuit held that "a sale of the assets of one corporation to another for cash without the retention of *any interest* by the seller in the purchaser is quite outside the objects of merger and consolidation statutes". Certiorari was denied, 288 U. S. 599.

Thus it will be seen that the exterior boundaries of the merger or consolidation concept as modified and expanded by the parenthetical words, are the continuation by the seller of "an interest in the affairs of the purchasing company". Note that the extent of the interest is neither described nor made material. "Any interest" were the conditioning words in the *Cortland Specialty Co.* opinion. Quality not quantity controls. It is only in part (B) of Section

203 (h) that quantity assumes importance. We mention this, because as shall be seen later, the Court below confounded parts (A) and (B) in this respect. All that is required for (A) is that there be *a* continuity of an interest.

What constitutes "an interest" is a question that need not long arrest attention—at least not for the purposes of this case. Section 204 (a) (7) of the Act, which is interlinked with Section 203, says that if in a reorganization, an "interest or control" of 80% or more in the assets involved, remains in the same persons, then; the acquiring corporation stands in the shoes of the transferor for the purpose of admeasuring gain or loss on a subsequent sale. What was meant by "interest" came up for adjudication in *Keen & Woolf Oil Company* v. *Commissioner,* 49 Fed. (2d) 45 (C. C. A. 5). The court said:

> "'Interest' refers to ownership, and may be retained either through preferred or common stock, and independently of voting power."

This view is likewise proclaimed in the *Cortland Specialty Co.* case, when the court said:

> "As no stock was issued against the transfer, the conditions for an exemption were not fulfilled * * *."

The same point also came up in *Mead Coal Co.* v. *Commissioner,* 72 Fed. (2d) 22 (C. C. A. 4), and the court declared:

> "It should not be necessary to add that the issuance to the old stockholders of stock in the new company provided the essential element, as the term reorganization has been defined, of a continuity of interest from the old corporation to the new."

It is thus authoritatively established that the exchange of substantially all the assets of a corporation for a stock interest in the transferee corporation squarely meets the statutorily defined concept of reorganization in Section 203(h) (1) (A) of the Revenue Act of 1926. That the preferred stock received by petitioner qualifies as a stock interest and a proprietary interest in the affairs of the transferee, will be the thesis of the next point in the argument.

II.

Preferred stock, though limited as to dividends and voting privileges, and subject to retirement, is a proprietary interest in the affairs of a corporation.

It would be a work of supererogation to linger here too long in the light of this Court's holding in *Atlantic City Electric Company* v. *Commissioner,* 288 U. S. 152. The taxpayer there contended that in determining whether (for the purposes of consolidated returns) two corporations really represent a single enterprise, no common ownership need exist as to preferred stock with voting rights, where the stock is redeemable at any time and has a limited interest in dividends. In rejecting the contention, this Court, through Mr. Chief Justice Hughes, said:

> "Despite redeemability and the limitation of dividends, the owners of the preferred stock were not in the position of creditors, but were stockholders with a proprietary interest in the corporate undertaking * * *."

Lesser luminaries in the field include the *Keen & Woolf Oil Co.* case, *supra,* characterizing preferred stock as representing an ownership interest, regardless of voting power. So, also, *I. Unterberg & Co.* v. *United States,* 64 Ct. Cls. 197, where the taxpayer unsuccessfully contended that (for invested capital

purposes) certain notes were the equivalent of preferred stock, the Court saying:

> "Preferred stock entitles the holder to an interest in the assets of the corporation, with a voice in its management, and to the right to share in its surplus profits."

Even though redemption is at the option of the stockholders, preferred stock makes for a proprietary and not a creditor relationship, *Finance & Investment Corp.* v. *Burnet,* 57 Fed. (2d) 44 (C. A. D. C.):

The cases are too multitudinous to permit selective citation where taxpayers contended for deductibility of dividends on retirable preferred stock as being the equivalent of interest, only to be consistently and properly turned down by the courts and the Board of Tax Appeals. *National Cottonseed Products Corp.,* 28 B. T. A. 67, is indeed interesting in this respect, involving as it did preferred stock where the issuer concurrently entered into an agreement to repurchase the stock at fixed dates.

As applied to the very issue at bar, the Board of Tax Appeals held an exchange of assets for preferred stock and cash to be a reorganization in *National Pipe & Foundry Company,* 19 B. T. A. 242, and *First National Bank of Champlain, N. Y.,* 21 B. T. A. 415; *Bruce,* 30 B. T. A. 80; *First Seattle Dexter Horton National Bank,* 27 B. T. A. 1242, affirmed 77 Fed. (2d) 45 (C. C. A. 9). Preferred stock was also the pivotal ingredient for reorganization in *Harrison,* 30 B. T. A. 966, and *Fifth Ave. Bank of New York,* 31 B. T. A. 945. It is noteworthy that in the latter case the reorganization conclusion was reached even though the preferred stock was redeemed within 10 days after issuance.

A "recapitalization" has been part of the defini-

tion of reorganization beginning with the Revenue Act of 1921 right through the Revenue Act of 1934 now in force. Article 112(g)-2 of Regulations 86 (promulgated under the 1934 Act) specifically designates a security exchange involving the issuance of preferred stock as constituting a recapitalization, and hence, a reorganization, regardless of the type and features of the preferred stock. See also Article 112(b) (2)-1 of Regulations 86.

Renewing acquaintances with the case at bar, petitioner in the transfer of its assets, acquired in exchange 12,500 shares of preferred stock (constituting the entire authorized and outstanding issue) of the new company. That obviously gave it a continuing interest in the new enterprise. The transaction thus comes squarely within the definition of reorganization implanted in the statute and as interpreted by this Court.

In the face of a conclusion so irresistibly reached, the basis for an opposing position taken by the lower court must necessarily be called up for consideration. Dissecting the opinion below, it will be found that the court believed there were two impediments against the holding of reorganization: first, that petitioner did not acquire a controlling interest over the affairs of the transferee, and second, that petitioner continued in existence. From these, the court concluded that a sale and not a reorganization took place. Petitioner will endeavor to establish that the acquisition of a controlling interest over the transferee is not a prerequisite of reorganization under Part(A) of the statutory definition. Likewise, it will try to show that continued existence of the transferor is not a deterrent; but even if it be, petitioner substantially meets that requirement. If petitioner succeeds in these respects, the foundational structure of the decision below, perforce crashes.

III.

A controlling interest over the transferee corporation is unnecessary for an exchange to qualify as a reorganization under Section 203(h) (1) (A). It is only under Section 203(h) (1) (B) that the element of control becomes a factor.

It may be well at this point to repeat the statutory definition of a reorganization in so far as here material, to see just where and how the element of control of the transferee enters into the picture.

> "(1) The term 'reorganization' means (A) a merger or consolidation (including the acquisition by one corporation of * * * substantially all the properties of another corporation), *or* (B) a transfer by a corporation of all or a part of its assets to another corporation *if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred,* * * *."*

The foregoing immediately discloses that it is only the disjunctive part (B) of the definition of reorganization that requires "control". We, here, have nothing to do with (B). If petitioner can find repose anywhere, it is under (A). Now, (A) and (B) are distinct from one another. Their respective provinces are clearly explained in G. C. M. 1753, VI-1 CB 138, as follows:

> "Section 203 (h) (1) (A) is not inconsistent with section 203 (h) (1) (B). One supplements the other. For example, a transfer of all the assets of a corporation constitutes a reorganization under the second part

> of definition (A) irrespective of the element of 80 per cent control demanded by definition (B). Again, a transfer of but a part of the assets of a corporation can never, of itself, result in a reorganization under section 203 (h) (1) (A), but it does result in a reorganization under section 203 (h) (1) (B) if there is present an additional element, namely, immediate control of the transferee corporation by the transferor or its stockholders, or both."

Whether (B) can be engrafted on or fused into (A), as the court below seems to have done, was a field of inquiry that was given most painstaking and comprehensive consideration in *Minnesota Tea Company* v. *Commissioner*, 76 Fed. (2d) 797 (C. C. A. 8), certiorari granted October 14, 1935. After intensively reviewing the wording of the statute, the long-established administrative construction, the avowed intent and purpose of Congress as gleaned from the legislative history of the various Revenue Acts, and the adjudications on the subject, the Eighth Circuit reached the following conclusion:

> "No particular percentage of the stock of the transferee to be received by the transferor is specified or required. We find no ground for holding that the 'continuance of interest' must be of essentially the same interest, or that it must be controlling interest. The provision for percentage of stock to be received, specified in clause (B) reorganizations, has no application here."

The Court is respectfully referred to the full opinion in the quoted case because it is so apposite and illuminating. Some of the other cases, and authorities

to the same effect and not cited in the *Minnesota Tea Company* decision, are collected in the footnote.*

The Tenth Circuit reached an opposite conclusion in *West Texas Refining and Development Company* v. *Commissioner*, 68 Fed. (2d) 77, but it is submitted that its holding in this respect is untenable in view of what has here preceded. Respondent seems to have conceded as much in its petition for a writ of certiorari (page 10) in the *Minnesota Tea Company* case when respondent said "We do not contend, as suggested by the court below, that the requirement of control, found in clause (B), is to be incorporated in clause (A)".

We return to the point of beginning. There is no requirement under (A) that the transferor acquire a controlling interest over the affairs of the transferee. The court below was therefore in error in interposing lack of such interest as defeating petitioner's cause.

IV.

Dissolution of the transferor corporation is unnecessary for an exchange to qualify as a reorganization under Section 203(h) (1) (A); but even if necessary, there has been here substantial compliance with such requirement.

No potency or magic is placed upon dissolution by the statute. In point of fact, dissolution is not

* *Howard* v. *Commissioner*, 56 Fed. (2d) 781 (C. C. A. 6); *Barker*, 28 B. T. A. 657; *Harrison*, *supra*; *Woodward*, 30 B. T. A. 1217; *Armstrong*, 31 B. T. A. 418; *Fifth Ave. National Bank of New York*, *supra*. See also G. C. M. 1345, VI-1 C. B. 15; G. C. M. 747, IX-1 C. B. 184; I. T. 2662, IX-2 C. B. 41. Likewise, Baar and Morris, "Hidden Taxes in Corporate Reorganizations", pp. 47, 85; Satterlee, "The Income Tax Definition of Reorganizations", The Tax Magazine, Vol. XII, p. 639 (Dec. 1934).

even mentioned. If anything, continued existence of the transferor is definitely implied since under the parenthetical matter, the acquisition by one corporation of the majority of the stock of another corporation likewise constitutes a reorganization, and the ownership of the majority of the stock is not ordinarily sufficient to swing a dissolution.

Furthermore, reference to Section 203(c) of the Act brings out forcibly that dissolution may, under given circumstances, destroy rather than create the tax deferred status. Under that section, if a corporation acquires stock in a reorganization and distributes it to its stockholders, the distribution is tax-free to the stockholders provided they do not surrender any of their stock in the distributing corporation, which is another way of saying, providing that the distributing corporation continues in existence. It would be a bizarre rule, indeed, that made dissolution omnipotent under Section 203(h) (1) (A), and at the same time blighted the application of Section 203(c) because of the dissolution.

The lower court evidently had in mind that in a merger, one of the existing corporations is extinguished, and that in a consolidation, all of the existing corporations are extinguished. That is true of literal mergers or consolidations, but we have already seen that the whole idea of the parenthetical clause was to get away from "merger" or "consolidation" in the technical sense, and to expand the field so that even where one corporation does not go out of existence, but instead a majority of its stock or substantially all its properties are acquired by another corporation, in which corporation the transferor acquires a stock interest, the tax consequences are the same as if a strict merger or consolidation took place.

Whether or no dissolution is required under (A) was thoroughly canvassed by the Second Circuit in *John J. Watts* v. *Commissioner,* 75 Fed. (2d) 981, certiorari granted October 14, 1935. The court carefully traced the whole course of the legislative history and administrative construction on the point (to all of which reference is hereby had) to the following end:

> "Having had the opportunity, it is to be presumed that if Congress had intended, contrary to the regulation in force, to have the gain from such an exchange as this be tax free only when there was a dissolution of one of the corporations or some other change in the corporate structure such as would commonly take place in a merger or consolidation, strictly speaking, it would have said so. The fact that it changed a related part of the statute to remove any doubt as to the validity of a regulation and at the same time reenacted the part which had been construed by the regulation which governs here shows an adoption of such construction. *National Lead Co.* v. *United States,* 252 U. S. 140; *United States* v. *Cerecedo Hermanos y Compania,* 209 U. S. 337; *Francisco Sugar Co.* v. *Commissioner,* 47 Fed. (2) 555.

Precisely, the same destination was reached in the *Minnesota Tea Company* case, *supra.* See also *Harrison, supra.* Continued existence of the transferor, therefore, provides no obstacle in the path leading to reorganization.* A different conclusion appears to have been reached by the Fourth Circuit in *The G. and K. Manufacturing Company* v. *Com-*

* See also Baar and Morris, "Hidden Taxes in Corporate Reorganizations", pp. 68, 85; Satterlee, "The Income Tax Definition of Reorganizations", The Tax Magazine, Vol. XII, p. 639 (Dec. 1934).

missioner, 76 Fed. (2d) 454, certiorari granted October 14, 1935. (However, the core of the decision in that case seems to be predicated on the factual question as to whether substantially all of the assets were transferred.)

But even if absence of continued existence of the transferring corporation be assumed a requisite, it would be no thorn in petitioner's path. Petitioner's stockholders voted that the corporation, after consummating the reorganization, "shall cease operation, and the directors and officers thereof shall proceed to liquidate the corporation and cause the same to be dissolved". While a technical dissolution was not effected, the record shows (R. 12) that the corporation has been inactive. Its existence has been nominal in a corporate shell. Its death had been encompassed. All that remained was the burial. That it is the former event that really counts, was set forth in *Aluminum Goods Mfg. Co.* v. *Commissioner,* 56 Fed. (2d) 568 (C. C. A. 6); affirmed 287 U. S. 544. In that case, affiliation rather than reorganization was involved, but the principle is pervasive. Said the court:

> "To ascertain when the status of affiliation terminates, attention is directed to the subsidiary's death, not to its burial."

To the same effect see *Frelmort Realty Corp.,* 29 B. T. A. 181, 186.

The retaining of liabilities to which the court below alludes, has reference to the obligation to pay the 1926 income tax, and the 1926 bonus to employees. These were items requiring prompt liquidation in the ordinary course and tie in with the reservation of $100,000 cash by petitioner. With these items out

of the way, the corporate structure was denuded. The omission to carry out the formality of the dissolution step can not submerge its actuality. The corporate cupboard was bare and its effectual existence terminated.

If, therefore, continued existence must be negatived to comport with reorganization, petitioner may still be counted in the reorganization ranks.

CONCLUSION.

The exchange of substantially all the assets of a corporation for all the preferred stock of the transferee corporation (plus cash) is a reorganization. Neither control of the transferee nor dissolution of the transferor is essential. (The latter, if required, is substantially present in this case.) This conclusion is proclaimed by the statute and ingrained by legislative history, years of administrative interpretation followed by statute reenactment, and judicial opinion.

The decision of the Circuit Court of Appeals should be *reversed*.

Respectfully submitted,

J. S. SEIDMAN,
Counsel for Petitioner.

November, 1935.

APPENDIX.

The Revenue Act of 1926, c. 27, 44 Stat. 9, provides in part as follows:

SEC. 203. (a) Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 202, shall be recognized, except as hereinafter provided in this section.

(b) (2) No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

(3) No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

(c) If there is distributed, in pursuance of a plan of reorganization, to a shareholder in a corporation a party to the reorganization, stock or securities in such corporation or in another corporation a party to the reorganization, without the surrender by such shareholder of stock or securities in such a corporation, no gain to the distributee from the receipt of such stock or securities shall be recognized.

(e) If an exchange would be within the provisions of paragraph (3) of subdivision (b) if it were not for the fact that the property received in exchange consists not only of stock

or securities permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then——

(1) If the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange, but

(2) If the corporation receiving such other property or money does not distribute it in pursuance of the plan of reorganization, the gain, if any, to the corporation shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property so received, which is not so distributed.

(h) As used in this section and sections 201 and 204——

(1) The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected.

(2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations

in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation.

(i) As used in this section, the term "control" means the ownership of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

(U. S. C. Sup. V, Title 26, Sec. 934.)

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1935.

JOHN A. NELSON COMPANY, PETITIONER,

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE.

ON A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

REPLY BRIEF FOR PETITIONER.

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THE COURT PRESS, N. Y. C.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1935.

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JOHN A. NELSON COMPANY, PETITIONER,

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COMMISSIONER OF INTERNAL REVENUE.

REPLY BRIEF FOR PETITIONER.

Respondent assigns five particulars in respect of which it is asserted that the statutory requirements for the existence of a reorganization have not been met. It will not entail more than a fleeting consideration to dispose of each of these items.

(1) *No Plan of Reorganization.* Respondent's argument here is best put at rest by the following sentence from the opinion in the *Watts* case: "The plan of reorganization was the contract made and performed."

Respondent says that "sale" not "reorganization" was in the winds. To that end, respondent calls up a group of facts that do not advance the case on the merits, one way or another. It is of no consequence whether Elliott-Fisher Company invested cash or business property in the new company; nor does it matter how close to or dissimilar from petitioner's corporate charter was that of the new company, nor by whom the new company's charter terms were dictated. The only phase of consequence in this nar-

row approach is that the new company came into being to, and did, *succeed to the business* of petitioner by acquiring all of petitioner's assets.

Respondent then points to the use of the word "sale" at times in petitioner's minutes referring to the transaction. If nomenclature is to flourish, there must also be put into the hopper, the following from the same minutes: "The President ordered the Secretary to submit to the meeting a proposed agreement * * * providing for a *reorganization.*" That expression was repeated three times thereafter. In the agreement itself "sale" is not used, but rather "convey and transfer" (R. 16, 17). The Government in the deficiency letter described what took place as a *"sale merger"* (R. 8).

It is of course fundamental that names do not make facts, but that the real character of a transaction controls. It is interesting to observe, however, that in the *Pinellas* case, the Supreme Court uses "seller" and "purchasing company" as descriptive of participants in a reorganization, when it says:

> "Certainly we think that to be within the exemption, the *seller* must acquire an interest in the affairs of the *purchasing* company more definite than that * * *."

See also the *Barker* case, where the transaction was specifically described as a purchase and sale, but withal, was held to be a reorganization for tax purposes.

(2) *No "Stock or Securities" Received.* To sustain this branch of his argument, respondent seeks to have the statute construed so that its unequivocal

reference to "stock or securities" shall be effaced, and the doors barred to everything but the highly equivocal "evidence of ownership which gives a voice in the management". The very statement of the proposed upheaval in statutory language and concept, is sufficient to condemn it.

We need not, however, leave the matter in this way in the face of affirmative Congressional prescription that "stock or securities" was not to be metamorphosed into "*voting* stock or securities". We are here concerned with Section 203. In Section 203(i), Congress defined the word "control" as being the ownership of at least 80% of the "voting stock" and at least 80% of "all other classes of stock of the corporation". We thus have clear Congressional awareness of the difference between voting stock and other stock. In another part of the same section Congress delimited the field in which no gain or loss was to be recognized in reorganizations. Had Congress there desired to confine that aspect to cases involving only voting stock, it would have been perfectly natural, if not necessary, under the circumstances, that it expressly say so. Instead, it used the word "stock" without qualification or equivocation, thereby generically subsuming into the tax free status not only "voting stock" but also "all other classes of stock".

Preferred stock is of course stock, by the very nature of things. "From the legal point of view, it should be remembered that a preferred shareholder is just as much a shareholder, in contrast to the creditors of the corporation, as the common shareholder." Dewing, "Financial Policy of Corporations", p. 45.

The status of preferred stock strikes even more deeply. Under the laws of many of the states, preferred stock—regardless of voting power or other

features, but merely as a generic class—may be used as the sole fulcrum around which to pivot a statutory merger or consolidation. Thus, as to the laws of New Mexico, Parker's "Corporation Manual", 33rd Edition, p. 919, gives the following digest.*

> "* * * the consolidated corporation may purchase, acquire, hold and dispose of the stocks of other corporations of this state or elsewhere, and exercise in respect thereto all the powers of stockholders thereof, and may issue capital stock, *either common or preferred,* or both, to such an amount as may be necessary, to the stockholders of such merging or consolidating corporations in exchange or payment for their original shares, in the manner and on the terms specified in the agreement of merger or consolidation; which may fix the amount and provide for the issue of preferred stock based on the property of stock of the merging or consolidating corporations conveyed to the consolidated corporation, as well as upon money capital paid in." (Chap. 32, Sec. 219, New Mexico Statutes, Annotated, Compilation of 1929.)

Both petitioner and respondent join hands in acknowledging a statutory merger or consolidation as constituting a reorganization for income tax purposes. Respondent goes further and basically premises his defense, in the series of cases now before this Court, on the contention that only mergers and consolidations or transactions partaking of their nature qualify under Part (A) of the tax definition. In any event, with preferred stock, regardless of voting power, able to assume complete command of strict

* Preferred stock is expressly provided for as a merger or consolidation medium by Kansas (Revised Statutes of 1923, Section 17-301); Maryland (Bagby's Annotated Code of Maryland 1924, Article 23, Section 33); New Jersey (Compiled Statutes, Section 106); New York (Stock Corporation Law, Section 86, as amended by L. 1931, c. 55).

mergers and consolidations, it automatically follows that such stock can certainly hold the fort in transactions "which in strictness can not be designated as either merger or consolidation" (*Pinellas* case). Preferred stock must hence represent the quality of "stock or securities" that may constitute the predicate for reorganization in the tax sense.

(3) *Large Proportion of Cash to Stock.* Respondent revives the argument about sale versus reorganization on the basis of the large cash amount involved. The statute itself is the complete answer to this argument. Section 203(e) provides for the continued status as a reorganization, though in addition to stock or securities there is received "other property or money". The quantum of other property or money is in no way limited or prescribed. What is prescribed is that the money cannot be received tax-free. To the extent that it represents gain, it is immediately taxed either to the receiving corporation, or, if distributed by the latter, then to its stockholders. There is therefore, no tax exemption or deferrment so far as the money is concerned. But the fact that money is involved, in no way either enhances or detracts from the reorganization status under the statute, regardless of amounts or proportions.

The definition of reorganization in the Revenue Act of 1934—Section 112 (g)(1)—is of no small interest in this respect, in view of its antecedents and legislative history. From Appendix B and D of respondent's brief in the *Minnesota Tea Co.* case (now pending before this Court), it is clear that the subject of reorganizations was comprehensively reviewed by and for Congress in the embryonic stages of the Revenue Act of 1934. The Joint Committee

on Internal Revenue recommended the complete elimination of the reorganization section from the Act, pointing out, among other things, how the section provided a basis for tax avoidance. The Treasury recommended, and Congress agreed merely to a redraft of important phases of the reorganization provisions. It is noteworthy that as thus redrafted, Congress retained the idea of reorganization where substantially all the assets of a corporation are acquired for stock and money. The feature new to the Revenue Act of 1934 was that the stock must be "voting stock". But the point here material is that no limitation whatsoever was placed on the proportion of money that may be received in relation to stock. To the contrary, the statute provided that all that need be involved is "a part" of the voting stock. One share of stock and an unlimited amount of cash would still qualify as a reorganization under a definition that was drafted after years of experience with cases precisely like those now before this Court. It is thus obvious that no meritorious argument can be advanced based on the quantum relationship between stock and money, as a determinant of the essence of reorganization.

(4) *All Liabilities Not Assumed.* The new company assumed all the liabilities reflected by petitioner's balance sheet and assumed all disclosed contracts of petitioner and its subsidiaries (R. 17). Because liability was not assumed for the 1926 bonus to two of petitioner's employees and for the 1926 corporate income tax (R. 19-20), respondent argues that this derogates from merger or consolidation.

In the first place, the statute concerns itself solely with the acquisition of substantially all the assets. No requisite is prescribed as to assuming any liabili-

ties, no less all the liabilities. Furthermore, we are agreedly not dealing with a technical merger or consolidation. We qualify, if we qualify at all, by virtue of the parenthetical clause in the statute that expands the field beyond strict mergers or consolidations. The highly limited reservation of liabilities in this case cannot therefore usurp unto itself any significance.

(5) *No Dissolution.* This phase has already been fully covered in petitioner's brief (pp. 17-21). Respondent points to the change of name, provided for in the agreement with Elliott-Fisher Company, as contemplating petitioner's continued existence. In point of fact, however, the change was to enable the new company to use petitioner's name (R. 19). If anything, therefore, this shows absorption and succession from the old company to the new.

Again the conclusion is reached that the decision of the Circuit Court of Appeals should be reversed.

Respectfully submitted,

J. S. SEIDMAN,
Counsel for Petitioner.

November, 1935.

In the Supreme Court of the United States

October Term, 1935

No. 61

JOHN A. NELSON COMPANY, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT

We do not oppose the granting of a writ of certiorari in this case.

Petitioner, on November 18, 1926, entered into a contract with Elliott-Fisher Company, under the terms of which the latter agreed to organize a new corporation and purchase all of its voting common stock. Petitioner obligated itself to convey to the new corporation all of its assets, except $100,000 in cash. The new corporation assumed all the ordinary obligations of the petitioner and in payment of the assets transferred, issued, and deliv-

ered to petitioner all of its preferred nonvoting stock and $2,000,000 in cash. (R. 28–32.) This preferred stock was callable at any dividend date upon thirty days' notice, at the option of the new corporation. (R. 14.) The petitioner immediately used part of the cash so received to retire its own preferred stock and distributed the preferred stock of the new company and the balance of the cash to its common stockholders. (R. 31.) The question is whether or not the transaction here involved constituted a reorganization within the meaning of Section 203 of the Revenue Act of 1926.

The court below held that the transaction does not come within the intendment of the statutory definition of reorganization; that it was a sale; that it did not partake of the nature of a merger or consolidation, nor did the petitioner control the new corporation which acquired its assets. We submit that the court below applied the proper principles and reached a correct result. As the preferred stock, callable at the option of the transferee, does not satisfy the statutory language "stock or securities", the decision might well rest solely upon the authority of *Pinellas Ice Co.* v. *Commissioner,* 287 U. S. 462. But in view of the more liberal construction of the statutory definition adopted in *Watts* v. *Commissioner,* 75 F. (2d) 981 (C. C. A. 2d), and *Minnesota Tea Co.* v. *Commissioner* (C. C. A. 8th), 76 F. (2d) 797, we do not feel warranted in opposing the petition.

The Government has filed petitions for certiorari in the *Watts* and *Minnesota Tea Co.* cases, Nos. 184 and 174, respectively, October Term, 1935.

Respectfully submitted,

STANLEY REED,
Solicitor General.
FRANK J. WIDEMAN,
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JUNE 1935.

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No. 61

In the Supreme Court of the United States

OCTOBER TERM, 1935

JOHN A. NELSON COMPANY, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT

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CITATIONS

Cases:

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Pinellas Ice Co. v. *Commissioner*, 287 U. S. 462 13

Statute:

Revenue Act of 1926, c. 27, 44 Stat. 9, 12:

Section 203 18

29443—35——1

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BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinions of the United States Board of Tax Appeals are reported in 24 B. T. A. 1031 (R. 26–39) and 28 B. T. A. 529 (R. 45–61). The opinion of the Circuit Court of Appeals is reported in 75 F. (2d) 696. (R. 74–78.)

JURISDICTION

The judgment of the Circuit Court of Appeals was entered February 23, 1935. (R. 78.) The petition for a writ of certiorari was filed May 20, 1935,

and granted October 14, 1935. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the term "reorganization" as used in Section 203 (h) (1) of the Revenue Act of 1926 includes a transfer by one corporation of substantially all its assets to another corporation in exchange for cash equivalent to the value of the tangible assets and preferred non-voting stock callable at the option of the transferee.

STATUTE INVOLVED

The pertinent provisions of the statute involved are contained in the Appendix, *infra*, pp. 18–19.

STATEMENT

The facts were stipulated (R. 12–26) and may be summarized as follows:

The petitioner is an Illinois corporation, with its principal office at Rockford, Illinois. During the years 1924 to 1926, inclusive, it was engaged in the manufacture and sale of milling and adding machines under the name of Rockford Milling Machine Company. In June, 1926, the name of the corporation was changed to Sundstrand Corporation, and in December, 1926, its name was further changed to John A. Nelson Company. (R. 12–13.)

On November 18, 1926, the petitioner and Elliott-Fisher Company, a Delaware corporation, entered

into an agreement (R. 13–22), wherein the petitioner agreed to convey and transfer to a new corporation to be formed by the Elliott-Fisher Company all of its assets, including patent accounts and accounts and notes receivable (with the exception of $100,000 cash) (R 14–17). The new corporation to be organized by the Elliott-Fisher Company was to have a presently issued capital stock consisting of 12,500 shares of $7 preferred stock of the par value of $100 each, with no voting privileges unless dividends thereon should be in default in the amount of at least $7 per share, and 30,000 shares of common stock without nominal or par value, each share of common stock carrying one vote. (R. 14–16.) Provision was made for the issuance of such additional shares of preferred stock as should be necessary in settling for the profits of petitioner before the closing date. (R. 16.)

The Elliott-Fisher Company also agreed that simultaneously with said transfer it would cause the new corporation to issue to, or in accordance with the direction of, the petitioner 12,500 shares of the $7 preferred stock of the new corporation and to pay to the petitioner $2,000,000 in cash. It was understood that the new corporation was to assume all of petitioner's ordinary obligations. (R. 17.) Simultaneously with, or at the option of Elliott-Fisher Company before, said transfer of petitioner's property to the new corporation, Elliott-Fisher Company agreed to cause the new cor-

poration to issue to Elliott-Fisher Company 90,000 shares of its common stock upon the payment therefor by Elliott-Fisher Company of $2,000,000 in cash. (R. 18.)

It was also understood that the new corporation could, at its option, use the name Sundstrand Corporation or Sundstrand as, or as a part of, its corporate name and that the petitioner would, when and as requested by the new corporation or Elliott-Fisher Company, make any necessary change in its corporate name so that the new corporation could be in a position to register to do business in any State in the United States. (R. 19.)

On November 18, 1926, at a special meeting of the petitioner's stockholders, called for the purpose of considering and acting upon the proposition made to it "to sell and dispose of all of its property and assets". (R. 22–23) aforesaid, the following resolutions were adopted (R. 23–24):

> Resolved that the Stockholders of the Company in meeting duly assembled hereby approve said Agreement, and authorize and direct the sale and transfer of all the property and assets of this Company upon the terms and conditions therein provided; and further
>
> Resolved that the Board of Directors and officers of this Company be and they hereby are authorized and directed to take such steps and to execute such instrument or instruments including said Agreement, with

such modifications thereof or supplements thereto, as in their opinion may be necessary or desirable in order to effect such sale and transfer; and further

Resolved, that upon the consummation of said reorganization and sale, the proceeds consisting of preferred capital stock and cash received from such sale be distributed immediately to the stockholders in the order of their preferential rights, the preferred stock being first fully redeemed and the balance distributed to the common stockholders; and further

Resolved, that this corporation, after the consummation of said re-organization and sale under the said agreement with Elliott-Fisher Company and the distribution of the proceeds in accordance with the reorganization plan to its stockholders in the manner provided above, shall cease operation, and the directors and officers thereof shall proceed to liquidate the corporation and cause the same to be dissolved.

At the same meeting the petitioner's name was changed to John A. Nelson Company. (R. 24.)

On December 31, 1926, pursuant to the terms of the agreement with Elliott-Fisher Company, all of the petitioner's properties (R. 13), with the exception of $100,000 in cash (R. 17), were transferred to a new corporation known as the Sundstrand Corporation of Delaware, and the petitioner received therefor 14,060 shares of the preferred stock of the

new corporation and $2,000,000 in cash (R. 13). The petitioner immediately used part of the cash so received to retire its own preferred stock and distributed the 14,060 shares of the new company's preferred stock and the balance of the cash to its common stockholders. (R. 13.) The petitioner, however, was not dissolved.

No gain or loss was recognized or reported by the petitioner in its 1926 income tax return with respect to the transaction referred to above. As of the date of the said transaction, however, the books of the petitioner showed a reserve for unrealized profit on installment sales in the amount of $322,980.29. This sum the respondent added to the petitioner's income, in arriving at the deficiency here in question, on the ground that the petitioner collected, when it exchanged its assets for stock and cash, 100% for the total outstanding installment accounts receivable. (R. 13.)

In the proceedings before the Board of Tax Appeals the facts were stipulated. The stipulation contained the following conclusion: "On December 31, 1926, petitioner was a party to a reorganization * * *." (R. 13.) This conclusion formed the basis of a division report promulgated November 30, 1931. (R. 26–39.) On December 19, 1931, pursuant to the provisions of Section 601 (b) of the Revenue Act of 1928, an order was entered by the Board on its own motion directing that the division report be reviewed by the entire Board.

(R. 39.) On June 23, 1933, the entire Board, with the exception of one dissent, sustained the respondent's determination and held that the transaction in question did not constitute a reorganization within the meaning of Section 203 (h) of the Revenue Act of 1926. (R. 45–61.)

The Circuit Court of Appeals affirmed the decision of the Board of Tax Appeals. (R. 78.)

SUMMARY OF ARGUMENT

1. The definition of "reorganization" upon which petitioner relies is contained in the same parenthetical clause discussed in the brief for petitioner in *Guy T. Helvering, Commissioner of Internal Revenue,* v. *Minnesota Tea Company,* No. 174, present term. For the reasons there stated, we contend that the definition should be limited to mergers and consolidations or to transactions which partake of their nature.

2. The transaction here involved fails substantially to conform to certain basic elements found in mergers and consolidations. There was no plan of reorganization; petitioner received no stock or securities within the meaning of the statute; the proportion of cash to stock interest was so large that petitioner's proprietary interest was substantially changed; petitioner's liabilities were assumed only in part by the new company; and petitioner did not dissolve. Petitioner received cash equivalent to the value of its tangible assets, and received in addition only preferred stock callable at the option of

the transferee and having no voice in the management. We submit that petitioner's relationship to its assets was vastly different after the transaction and that such a substantial change does not constitute a reorganization.

ARGUMENT

I

THE STATUTE CONTAINS TWO OVERLAPPING DEFINITIONS OF "REORGANIZATION." THEY CAN BE RECONCILED ONLY BY RESTRICTING THE CLAUSE (A) DEFINITION TO TRANSACTIONS WHICH RESULT IN MERGERS OR CONSOLIDATIONS OR PARTAKE OF THEIR NATURE

The general rule of the statute is that gains upon exchanges are taxable. To this there are certain strictly defined exceptions. Petitioner contends that the transaction here involved is literally within the language of one of the exceptions (Section 203 (b) (3), Revenue Act of 1926 (*infra*, p. 18), as modified by Section 203 (e) (*infra*, p. 18)). Section 203 (b) (3) provides in substance that the gain will not be recognized where a corporation a party to a reorganization exchanges property in pursuance of the plan of reorganization solely for stock or securities in another corporation a party to the reorganization. Section 203 (e) provides for the case where money or property other than stock or securities enters into the transaction. The case turns upon whether the transaction involved was a "reorganization." The portion of the definition of reorganization upon which petitioner relies is as follows (Section 203 (h) (1)):

> The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of * * * substantially all the properties of another corporation * * *.

The Government contends that the parenthetical language upon which petitioner relies is colored and controlled by the words "merger or consolidation" and that to be within the definition a transaction must partake of the nature of a merger or consolidation, though it fails to satisfy all of its legal requirements. This contention is fully developed in the brief for petitioner in *Guy T. Helvering, Commissioner of Internal Revenue*, v. *Minnesota Tea Company*, No. 174, present term, and Point I of the Argument in that case is therefore incorporated herein by reference.

Petitioner contends that a strict construction of the statute will widen the field of losses, and hence that a liberal construction which will have the effect of postponing gains will be offset by a similar postponement of losses. This reasoning is unsound. The difficulty with a liberal construction of the statute is that it makes taxability depend entirely upon the procedural steps which are taken—that is, upon the mere form in which the transaction is cast. Since the form of the transaction can always be altered to suit the convenience of the taxpayer, the liberal construction of the statute permits transactions which are really sales to be deliberately brought within the statute by careful adherence to

the procedural requirements. But where a loss is involved the taxpayer can avoid the procedural steps which would make the transaction a reorganization and can carry out the transaction in such a manner that the loss will be allowable. Accordingly, the same transaction can be brought within the statute or not, depending upon whether a gain or a loss is involved. We submit that a more penetrating test is required and that the statute should not be exposed to manipulation by making the form of the transaction the test of taxability. The following excerpt from the dissenting opinion in the *Minnesota Tea Co.* case (76 F. (2d) 797, 805) is apposite here:

> If it is the law, it would be folly to close any large sale without including some of the purchaser's stock in the purchase price, especially as in this case, where the purchaser's stock was for sale on the New York Stock Exchange. Though the tax on gains from sales is not repealed, none but the simple would need to pay it.

II

THE TRANSFER TO THE NEW CORPORATION DID NOT SUFFICIENTLY PARTAKE OF THE NATURE OF A MERGER OR CONSOLIDATION TO BE TREATED AS A REORGANIZATION

In substance, the transaction which petitioner contends is a reorganization within the statutory language "the acquisition by one corporation of

* * * substantially all the properties of another corporation", is as follows: In 1926 petitioner was engaged in the manufacture and sale of milling and adding machines. In November of that year it entered into an agreement with the Elliott-Fisher Company whereby the latter undertook to organize a new corporation to acquire the assets of petitioner. The Elliott-Fisher Company agreed to purchase the entire issue of common stock of the new company for $2,000,000 cash. Petitioner agreed to transfer substantially all of its property in consideration of $2,000,000 and the entire issue of preferred stock of the new company. This transaction was consummated pursuant to the agreement, and petitioner used part of the cash to retire its own preferred stock and distributed to its common-stock holders the balance of the cash together with the preferred stock of the new company.

We think the transaction fails to satisfy the statute in several particulars: (1) there was no plan of reorganization; (2) petitioner received no "stock or securities" within the meaning of the statute; (3) the proportion of cash to stock interest was so large that petitioner's proprietary interest was substantially changed; (4) petitioner's liabilities were assumed only in part by the new company; (5) petitioner did not dissolve.

We shall briefly discuss each of the points enumerated above.

(1) The record evidences a plan of sale rather than a plan of reorganization. While the trans-

action resulted in the creation of a new corporation, it was not the successor of petitioner and the Elliott-Fisher Company. The petitioner transferred assets to the new company but the Elliott-Fisher Company did not transfer any business property. The latter merely made a cash investment in the new company, whose assets consisted of those transferred by the petitioner. The Elliott-Fisher Company caused the new company to be organized (R. 14), with such powers, charter provisions, and bylaws as Elliott-Fisher Company deemed necessary or advisable (R. 16). The new company was the representative of the Elliott-Fisher Company in the transaction and it was no part of the plan that the new company should succeed to any of petitioner's corporate rights except its name. The new company's relation to petitioner was that of a purchaser of its assets. The agreement described the transaction as a purchase. (R. 16.) The proposed agreement between petitioner and the Elliott-Fisher Company was submitted to the stockholders of petitioner as a plan (R. 23) "providing for a reorganization upon the terms and conditions therein stated and for the sale and transfer of all of the property and assets of this company." The resolution adopted by petitioner's stockholders approved the agreement and authorized (R. 23) "the sale and transfer" of petitioner's assets. Another resolution authorized the Board of Directors to execute such instruments

as should be necessary or desirable "in order to effect such sale and transfer." (R. 23.) While the resolutions employed the term "reorganization", as well as the term "sale", the two are wholly inconsistent. The record does not contain the instrument of actual transfer but the authority given to the Board of Directors would seem to contemplate a bill of sale. The Board of Tax Appeals held that the agreement was a contract of sale. (R. 59.) The Circuit Court of Appeals held that the transaction essentially constituted a sale. (R. 76.)

(2) In exchange for its assets petitioner received $2,000,000 in cash and 14,060 shares of preferred stock in the new company. (R. 52.) This stock carried no voting rights except in the event of default in the payment of dividends. (R. 15.) It was callable in whole or in part on any dividend date at the option of the new corporation. (R. 14.) Accordingly the preferred stock gave petitioner no voice in the management of the company which acquired its assets and it was within the power of the new company to eliminate whatever proprietary interest was represented by the preferred stock. It is settled that a corporation which transfers its assets to another in a reorganization must preserve a continuity of interest in the assets by securing an intimate interest in the affairs of the transferee. *Pinellas Ice Co.* v. *Commissioner*, 287 U. S. 462.

Since the statute recognizes as a reorganization a transfer solely for stock or securities (Sec. 203 (b) (3), *infra*, p. 18), it seems logical that the required continuity of interest should be represented by the required stock or securities. A corporation which transfers its assets for stock or securities which represent no voice in the management has clearly parted with an essential element of its proprietorship. Such an exchange results in a substantial change in the transferor's position and would seem to be beyond the purview of a statute designed to relieve formal changes from the tax.

In view of the clause (B) definition of reorganization, which covers a transfer of assets in exchange for a controlling interest in the transferee, it is clear that Congress was unwilling that a corporation which parted with its assets should change its position so radically that it lost substantial elements of direct ownership. Fitting the requirement for receiving "stock or securities" into such a pattern, it seems entirely logical that in order to satisfy the clause (A) definition the term "stock or securities" should be limited to evidence of ownership which gives a voice in the management. The Board of Tax Appeals held that this nonvoting stock represented little more interest in the affairs of the acquiring corporation than did the notes in the *Pinellas* case. (R. 60.) The Circuit Court of Appeals held that the preferred stock did not represent a continuity of interest (R. 76), and

we submit that it did not represent "stock or securities" within the meaning of the statute.

(3) The 14,060 shares of preferred stock had a par value of $100 each (R. 14), and accordingly represented $1,406,000. In addition, petitioner received $2,000,000 in cash. Petitioner's tangible net worth was in excess of $2,090,000 (R. 18), and since it withheld from the transfer $100,000 in cash, it is evident that the $2,000,000 cash received from the new corporation was substantially the value of its assets. At least it is clear that the $1,406,000 in preferred stock was not equivalent in value to the assets transferred by petitioner. As explained in the brief for the petitioner in the *Minnesota Tea* case, *supra*, cash and property other than stock or securities were permitted to enter into a reorganization only as "boot", and we therefore submit that proportion of cash to stock and the disparity between the value of the new stock held by the petitioner after the transfer and the value of its assets before the transfer is so great that this transaction resulted in a substantial change in its position. The transaction has all the aspects of a sale of petitioner's assets for cash, with preferred stock added as a bonus. We submit that only by giving the statute a literal application and departing from the principles which actuated Congress in enacting the reorganization provisions, can this transaction be said to be a reorganization.

(4) The new corporation assumed all the ordinary liabilities of the character and approximate

amount shown on the balance sheet attached to the agreement. (R. 17, 22.) The new corporation was specifically protected against all other liabilities. Petitioner agreed to assume liabilities for certain bonuses (R. 19) and tax liabilities (R. 20). As pointed out in the brief for petitioner in the *Minnesota Tea* case, *supra*, it is one of the indicia of a merger or consolidation that the successor corporation assumes all of the liabilities of the predecessor companies, and the limitation of liability here serves to emphasize the point that petitioner's corporate business was not merely continued in a new form. It was a new and distinct enterprise, just as widely separated from petitioner corporation as though it had purchased petitioner's assets exclusively for cash.

(5) Although the stockholders of petitioner adopted a resolution to cease operations and authorized the directors and officers to proceed to liquidate the corporation and cause its dissolution (R. 24), it is significant that the record shows no action taken pursuant to such authority. Petitioner still exists as a corporation, and at the same meeting at which dissolution was authorized the name of the petitioner was changed. (R. 24.) The Board of Tax Appeals pointed out (R. 60) that the agreement with the Elliott-Fisher Company looking to the change of name and the action of the stockholders pursuant thereto apparently contemplated the continuance of petitioner's corporate ex-

istence. We have contended in the *Minnesota Tea* brief that a reorganization should at least contemplate the dissolution of the predecessor corporation, but we do not think such a requirement is satisfied by the minutes of a stockholders' meeting which after nine years remain merely a resolution which has not been acted upon.

CONCLUSION

In view of the foregoing, we submit that the transaction here involved was not a reorganization, and that the decision of the Circuit Court of Appeals should be affirmed.

Respectfully submitted.

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NOVEMBER, 1935.

APPENDIX

STATUTE INVOLVED

Revenue Act of 1926, c. 27, 44 Stat. 9, 12:

SEC. 203. (a) Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 202, shall be recognized, except as hereinafter provided in this section.

(b) * * *

(3) No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

* * * * * *

(e) If an exchange would be within the provisions of paragraph (3) of subdivision (b) if it were not for the fact that the property received in exchange consists not only of stock or securities permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then—

(1) If the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange, but

(2) If the corporation receiving such other property or money does not distribute it in pursuance of the plan of reorganization, the gain, if any, to the corporation shall

be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property so received, which is not so distributed.

* * * * * *

(h) As used in this section and sections 201 and 204—

(1) The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected.

(2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation.

(i) As used in this section the term "control" means the ownership of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

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SUPREME COURT OF THE UNITED STATES.

No. 61.—October Term, 1935.

John A. Nelson Company, Petitioner, vs. Guy T. Helvering, Commissioner of Internal Revenue. } On Writ of Certiorari to the United States Circuit Court of Appeals for the Seventh Circuit.

[December 16, 1935.]

Mr. Justice McReynolds delivered the opinion of the Court.

The petitioner contests a deficiency income assessment made on account of alleged gains during 1926. It claims that the transaction out of which the assessment arose was reorganization within the statute. Sec. 203, Revenue Act, 1926, c. 27, 44 Stat. 9, 11, is relied upon. The pertinent parts are in the margin of the opinion in No. 174, announced this day.

In 1926, under an agreement with petitioner, the Elliott-Fisher Corporation organized a new corporation with 12,500 shares non-voting preferred stock and 30,000 shares of common stock. It purchased the latter for $2,000,000 cash. This new corporation then acquired substantially all of petitioner's property, except $100,000, in return for $2,000,000 cash and the entire issue of preferred stock. Part of this cash was used to retire petitioner's own preferred shares, and the remainder and the preferred stock of the new company went to its stockholders. It retained its franchise and $100,000, and continued to be liable for certain obligations. The preferred stock so distributed, except in case of default, had no voice in the control of the issuing corporation.

The Commissioner, Board of Tax Appeals and the court all concluded there was no reorganization. This, we think, was error.

The court below thought the facts showed "that the transaction essentially constituted a sale of the greater part of petitioner's assets for cash and the preferred stock in the new corporation, leaving the Elliott-Fisher Company in entire control of the new corporation by virtue of its ownership of the common stock."

"The controlling facts leading to this conclusion are that petitioner continued its corporate existence and its franchise

and retained a portion of its assets; that it acquired no controlling interest in the corporation to which it delivered the greater portion of its assets; that there was no continuity of interest from the old corporation to the new; that the control of the property conveyed passed to a stranger, in the management of which petitioner retained no voice.

"It follows that the transaction was not part of a strict merger or consolidation or part of something that partakes of the nature of a merger or consolidation and has a real semblance to a merger or consolidation involving a continuance of essentially the same interests through a new modified corporate structure. Mere acquisition by one corporation of a majority of the stock or all the assets of another corporation does not of itself constitute a reorganization, where such acquisition takes the form of a purchase and sale and does not result in or bear some material resemblance to a merger or consolidation."

True, the mere acquisition of the assets of one corporation by another does not amount to reorganization within the statutory definition. *Pinellas Ice Co.* v. *Commissioner,* 287 U. S. 462, so affirmed. But where, as here, the seller acquires a definite and substantial interest in the affairs of the purchasing corporation, a wholly different situation arises. The owner of preferred stock is not without substantial interest in the affairs of the issuing corporation, although denied voting rights. The statute does not require participation in the management of the purchaser; nor does it demand that the conveying corporation be dissolved. A controlling interest in the transfer corporation is not made a requisite by Sec. 203 (h) (1) (A). This must not be confused with par. (h) (2).

Finally, as has been pointed out in the *Minnesota Tea* case, par. (h) (1) (B) was not intended to modify the provisions of par. (h) (1) (A). It describes a class. Whether some overlapping is possible is not presently important.

The judgment below must be

Reversed.

A true copy.

Test:

Clerk, Supreme Court, U. S.